Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re **DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)**	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

WRITTEN DIRECT STATEMENT OF SOUNDEXCHANGE, INC.

Volume 1: Introductory Materials

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PUBLIC VERSION

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for the Written Direct Statement of SoundExchange, Inc.
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INTRODUCTORY MEMORANDUM TO THE WRITTEN DIRECT STATEMENT OF SOUNDEXCHANGE, INC.

SoundExchange, Inc. ("SoundExchange"), through its undersigned counsel, respectfully submits this Introductory Memorandum to its Written Direct Statement in accordance with 37 C.F.R. § 351.4. This Memorandum provides an overview of the evidence presented in SoundExchange's written direct case and briefly summarizes the testimony of its witnesses.

SOUNDEXCHANGE'S ROYALTY RATE PROPOSAL

SoundExchange proposes that the appropriate royalty rate for eligible nonsubscription transmissions and transmissions made by a new subscription service pursuant to 17 U.S.C. § 114 and the making of ephemeral recordings to facilitate such performances pursuant to 17 U.S.C. § 112 for the period between 2016 to 2020 for commercial webcasters be the greater-of the following per-performance rate and percentage of revenue:

	Per-Performance Rate	Percentage of Revenue
2016	$0.0025	55%
2017	$0.0026	55%
2018	$0.0027	55%
2019	$0.0028	55%
2020	$0.0029	55%

For noncommercial webcasters, SoundExchange proposes a minimum fee of $500 per station or channel, up to a maximum usage of 159,140 aggregate tuning hours. The same per-performance rates for commercial webcasters shall apply to usage by noncommercial webcasters in excess of 159,140 hours per month.

The royalty fee for ephemeral copies shall be included within, and constitute 5% of, all such royalty payments. SoundExchange proposes corresponding amendments to the definition of revenue and other necessary terms as explained more fully in SoundExchange's Proposed Rates and Terms.

SUMMARY OF WRITTEN DIRECT CASE

Since the Copyright Royalty Board last heard evidence and set rates for the webcasting industry, the market has evolved considerably. The market for music streaming services, and webcasting services in particular, has engendered widespread adoption by consumers, who are rapidly shifting their music consumption habits from "owning" copies of music (be they digital or physical) toward a model of music "access" via streaming services. Relatedly, over the past rate term, the industry has seen increasing "convergence" between programmed and customized webcasting services (also referred to as "non-interactive") and on-demand streaming services (also referred to as "interactive"), in both functionality and in the ways in which consumers engage with such services. As witnesses from record labels explain, consumers are likely to view these alternative streaming services as relatively close substitutes for one another.

Drawing from a thick market of available directly licensed agreements,[1] economist Dr. Daniel L. Rubinfeld concludes that directly-negotiated licenses for on-demand streaming

[1] SoundExchange has sought to analyze and present to the CRB Judges all relevant market evidence regarding direct licenses for the audio streaming of sound recordings. Unfortunately, shortly prior to the deadline for the submission of the parties' Written Direct (footnote continued)

services are the most comparable benchmarks for this rate-setting proceeding and that greater reliance upon such agreements than in prior proceedings is warranted. As noted, interactive and non-interactive markets are converging. Non-interactive services with a substantial degree of customization and personalization now come closer to replicating the *lean-forward* experience of on-demand services in a *lean-back* way. Further, music streaming services of all types are commonly available on mobile devices. Accordingly, webcasting services and on-demand streaming services are currently in competition for the same group of consumers. Moreover, these benchmark agreements are between willing buyers and sellers outside the direct shadow of the statutory license, involve the same or similar parties as the statutory license, and can be readily adjusted for any differences in rights compared to the statutory license. Lastly, no other market agreements are more comparable.

Dr. Rubinfeld further concludes that the market data supports a "greater-of" rate structure that includes a minimum per performance rate and a percentage of the revenues of the service. Indeed, a "greater of" structure has been almost uniformly followed by willing buyers and

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Statements, Apple Inc. ("Apple") – which acquired Beats Music, LLC ("Beats") following the commencement of these proceedings – and Spotify USA Inc. ("Spotify") raised pre-discovery objections to SoundExchange's inclusion of information relating to certain Beats and Spotify agreements in its direct case on the basis of confidentiality provisions in those agreements. Despite our best efforts to obtain Apple and Spotify's consent to the submission of this information, the parties have not yet reached a resolution of this issue. As a result, SoundExchange has had to redact references to certain information pertaining to Beats and its predecessor MOG, Inc., and Spotify from its Written Direct Statement. SoundExchange will continue to work with Apple and Spotify to resolve their objections so that it can provide complete information to the Judges. As soon as these issues are resolved, SoundExchange will submit the redacted information.

Relatedly, SoundExchange intended to submit information relating to the major record labels' agreements with Apple for its iTunes Radio service as part of its Written Direct Testimony. The record companies asked Apple to waive certain contractual provisions in these agreements that limit or prohibit the submission or reliance upon them in connection with this proceeding. Apple refused to do so. Accordingly, SoundExchange has not submitted information relating to these agreements for the Judges' consideration.

willing sellers in directly negotiated agreements between music streaming services and record companies. Witnesses from record labels explain that this rate structure accomplishes three key critical goals in today's rapidly evolving market: (1) guarantees a minimum return on investment as each use of a sound recording on one streaming service replaces a use of a sound recording on another streaming service; (2) allows the record companies to share in the upside of music streaming services when their very success is built on the investment and creative contribution of the record labels and musicians; and (3) preserves the inherent value in music.

Dr. Rubinfeld thus bases his assessment of the market rates for the statutory license upon a deep set of directly-licensed on-demand agreements. In so doing, he accounts for certain quantifiable terms that rights owners are able to obtain in the market but that are not required under the statutory license, including advances or minimum guarantees that ensure a base level of compensation, and marketing and promotional guarantees that protect and promote the market share of that record label. Dr. Rubinfeld's analysis is conservative in that there are other forms of valuable consideration, including equity guarantees, holdback rights for exclusive streaming partners, data usage for analysis, and security guarantees that deter privacy and protect content, which cannot be readily accounted for in a set of proposed rates.

The consideration that record labels and artists receive in exchange for the right to use sound recordings must be viewed in the overall context described above. The shift in the recorded music industry from an "ownership" model – in which consumers bought permanent copies of sound recordings – to an "access" model – in which consumers buy access to streaming services without buying an actual copy, has meant that webcasting revenues are now primary, not ancillary, revenue for copyright owners. This trend is likely to continue over the next rate term: As revenues attributable to webcasting and streaming are growing, revenues from

other sources, such as the sale of permanent downloads and CDs, are declining. Record company witnesses, including Dennis Kooker, President, Global Digital Business and U.S. Sales, for Sony Music Entertainment, explain how this change has impacted their business. Specifically, they explain how record companies have recognized and embraced this transition in consumer behavior, and how the royalty rate for webcasting must be set in this broad context of streaming as primary revenue to ensure that copyright owners can cover the costs of providing a wide range of music from new and established artists to an enormous and diverse group of consumers, and also receive a reasonable return on their investment. For artists, the impact of the transition is even greater. As they grow to depend more and more on revenues from webcasting, the rate must be commensurate to ensure that creativity is not deterred by rates too low to allow artists to make a living.

The testimony also describes the time, money, energy, and of course creativity that goes into the creation of every recording. Artist representative Fletcher Foster, President, CEO and Founder of Iconic Entertainment Group, explains the creative but arduous process involved in every recording. Raymond M. Hair, Jr., President of the American Federation of Musicians, testifies about the importance of the revenue stream from the statutory license to recording artists and musicians, who make a living by patching together revenue from many different sources to allow them to continue to make music. The record labels also invest substantial capital and take a huge risk on every artist. Independent record label witnesses Simon Wheeler, Director of Digital at the Beggars Group, Darius Van Arman, co-founder and co-owner of the Secretly Group of labels, and Jeff Harleston, General Counsel and Executive Vice President of UMG Recordings, Inc. explain the extraordinary efforts that are required by record labels' A&R departments to find and develop talent, giving musicians an opportunity to showcase their art.

Without the contributions of artists, record labels, and the countless other creative and industry professionals who bring recordings to life and to market, the webcasting industry would have nothing to stream. Webcasting services generate revenue from playing the music that others have worked so hard to create.

Finally, the efficient and effective operation of the statutory license simply would not be possible without SoundExchange. SoundExchange has administered the statutory license effectively for more than ten years and continues to enjoy the broad support of the industry. Accordingly, it should continue to be designated the sole collective.

SUMMARY OF THE WRITTEN TESTIMONY OF SOUNDEXCHANGE'S WITNESSES

SoundExchange's written direct case includes the written testimony of the following ten fact and four expert witnesses and one prior designated testimony.

I. FACT WITNESSES

Dennis Kooker is the President, Global Digital Business and U.S. Sales, for Sony Music Entertainment ("Sony"). The Global Digital Business Group handles digital distribution and sales initiatives on behalf of each of Sony's various label groups in the United States. Mr. Kooker's testimony provides a broad overview of a number of issues relevant to these proceedings, including the state of the market for streaming services, how statutorily licensed streaming services substitute for the sale of physical and digital records, and how such services undermine the ability of non-statutory services to attract paying subscribers.

Mr. Kooker's testimony first describes the substantial investments that a record company must make to discover, produce, manufacture, distribute and market sound recordings, and how a record company depends on realizing returns from those recordings in

order to continue to support the process of creating new music. His testimony further describes the myriad challenges that Sony and the record industry more generally face as a result of the industry's transition from a model of consumers "owning" copies of music and toward a model of music "access."

Specifically, while the record industry has generally embraced the transition to streaming models, Mr. Kooker's testimony describes the significant challenge in realizing reasonable returns from online streaming services models, particularly those that have been unable to convert users from "free" to paid subscriptions. His testimony discusses why statutory services – particularly those that offer customized radio offerings – generally fail to promote the sale of recorded music or subscriptions to paid offerings. Mr. Kooker further describes the increasing convergence between services that operate exclusively under the statutory license and non-statutory services. The functionality and consumer offerings provided by each type of service have become much more similar over the last few years and are likely to continue to converge – and how this further disincentives "free-to-listen" users from subscribing to paid tiers on licensed services.

Finally, Mr. Kooker's testimony describes a number of important elements of Sony's agreements with streaming services. These elements include monetary and non-monetary consideration that provide substantial consideration that the statutory license fails to provide.

Ron Wilcox is Executive Counsel, Business Affairs, Strategic and Digital Initiatives for Warner Music Group ("WMG"). Mr. Wilcox has been involved in negotiating agreements with digital service providers since the advent of Internet distribution. His testimony describes, amongst other issues, WMG's general approach to negotiating with digital services, including online streaming services.

First, Mr. Wilcox overviews the unique features of WMG's experimental trial deal with Clear Channel (now iHeartMedia) concerning Internet simulcast and non-simulcast transmissions. Mr. Wilcox describes the unique circumstances that gave rise to that deal, and also a number of important deal terms that provide substantial consideration to WMG. In addition, Mr. Wilcox explains that, in negotiations with streaming services, neither WMG nor streaming services generally negotiate rates for or separately allocate payments on account of the ephemeral copies such services need to operate.

Furthermore, Mr. Wilcox explains that audit rights are an important component of WMG's streaming agreements. His testimony describes the technical and industry-specific expertise required to conduct a royalty audit and explains why WMG's agreements generally do not require that a certified public accountant perform royalty audits with its digital partners. Finally, Mr. Wilcox explains the efficiency benefits of having a single licensing collective for the statutory license, and why SoundExchange should be that collective.

Aaron Harrison is Senior Vice President, Business & Legal Affairs, Global Digital Business, UMG Recordings, Inc. ("Universal"). He is responsible for negotiating Universal deals with numerous digital services, including online streaming services. Mr. Harrison's testimony discusses key monetary and non-monetary terms in Universal's deals with streaming services. These facts confirm the relevance of on-demand streaming service agreements as providing the applicable benchmarks for determining the rates and terms that willing buyers and willing sellers would negotiate for the rights granted under the statutory license. Mr. Harrison also explains why rates for on-demand streaming services have decreased over the past few years as these services seek to compete with statutory services that pay much less in royalty costs. He notes that statutory rates must increase over the next rate term for the market to reach

equilibrium.

Simon Wheeler is the Director of Digital at the Beggars Group, one of the largest collections of independent record labels in the world. Based on his quarter of a century of experience working on negotiating license agreements for sound recordings on behalf of independent record labels and artists, Mr. Wheeler describes what is required for an independent record company to directly license its sound recordings and the market value of independent record company sound recordings. He identifies the current music industry shift from a purchasing business model to an access business model, including how customized webcasting substitutes for other revenue in that model and how promotion is different in that model. Mr. Wheeler's testimony concludes by explaining why strong statutory license rates are important for independent record companies who directly license their sound recordings.

Darius Van Arman is the co-founder and co-owner of Secretly Group, a collection of prominent independent record labels in the United States, as well as their affiliated companies, including independent distributor SC Distribution. His testimony offers the perspective of the independent record company community in the United States, by explaining the various ways that independent record companies distribute their sound recordings, the challenges that independent record companies face in the directly-licensed market, and the resulting importance of a strong statutory license rate. Mr. Van Arman also explains why SoundExchange should be designated the sole collective to collect and distribute statutory royalties.

Raymond M. Hair, Jr. is the President of the American Federation of Musicians. Mr. Hair testifies about the contribution and the significance of the royalty in this proceeding from the perspective of the musicians he represents. In particular, Mr. Hair describes the perspective

of not only the featured artists who rely on royalties from SoundExchange, but of the non-featured artists who perform as session musicians as well. Finally, Mr. Hair describes the reasons why he believes SoundExchange should remain the sole collective for the purpose of collecting and distributing royalties.

Fletcher Foster is the President, CEO and Founder of Iconic Entertainment Group. Mr. Foster has spent thirty years in the music industry. He has worked across all aspects of the business. His testimony describes the creative process an artist undertakes to create a sound recording. He also describes the substantial investment and risk that a recording artist faces. Finally, Mr. Foster describes the importance of the performance royalty at issue in this proceeding to the recording artist, in particular over the next rate period.

Jeffrey S. Harleston is the General Counsel and Executive Vice President for Business and Legal Affairs for North America for the group of companies that are known as the Universal Music Group (collectively, "UMG"). Mr. Harleston describes the work of a record label, in particular the significant investment and attendant risks inherent in creating and releasing sound recordings. Mr. Harleston also explains that the risk of failure and loss in that endeavor falls squarely on record labels and artists—not digital services. Digital services benefit by having the ability to play the music that record labels release that is popular – without having to bear any of the risks inherent in creating it, and without having to bear any of the losses record labels incur in artist investment. Mr. Harleston concludes that digital services that build their business on record company and artist content should pay a fair price for that content that appropriately reflects this disparity in creative contribution, investment, costs and risks.

Michael Huppe is the President and Chief Executive Officer of SoundExchange. Mr. Huppe explains the growth that the webcasting industry has seen since SoundExchange

started distributing royalties in 2003 and the incredible importance that these royalties have for record labels and artists. His testimony also explains the numerous contributions that SoundExchange has made to the music industry. In particular, the efficient and diligent process that SoundExchange uses ensures that it manages the statutory payments in a manner that returns the greatest amount of revenues to the rightsholders and artists.

Jonathan Bender is the Chief Operating Officer of SoundExchange. His testimony provides background information about SoundExchange and its operations, and describes its processing and distribution of royalties over the last rate period. Mr. Bender also explains why SoundExchange should be the sole collective for collecting and distributing royalties, and provides support for SoundExchange's proposals with respect to the minimum fees, treatment of ephemeral royalties, and terms of the statutory licenses at issue in this proceeding.

II. EXPERT WITNESSES

Daniel L. Rubinfeld, Robert L. Bridges Professor of Law, Professor of Economics, Emeritus, University of California, Berkeley, and Professor, NYU Law School, presents testimony providing the economic basis for SoundExchange's rate proposal. Dr. Rubinfeld analyzes the market for music webcasting and provides his expert opinion on reasonable rates for the statutory licensee fees to be set in this proceeding for the period 2016-2020.

Dr. Rubinfeld begins his analysis with an overview of recent developments in the Internet music industry. He explains that there has been increasing convergence in functionality and the ways in which consumers engage with "non-interactive" or programmed and/or customized webcasting services, on the one hand, and "interactive" or on-demand streaming services, on the other hand. As a result, consumers are likely to view alternative services as relatively close substitutes for each other. Dr. Rubinfeld then

describes his proposed rate structure – a greater-of formula that includes a percentage of revenues and a per-play rate – and why that structure is economically appropriate for the commercial webcasting market and supported by nearly all the market agreements.

Dr. Rubinfeld analyzes directly licensed agreements and performance data under those agreements for webcasting services that were in operation between 2011 and 2014 and which fall into the following categories: Category A – on-demand or "interactive" services; Category B – programmed and/or customized webcasting or "non-interactive" services, including WMG's agreement with iHeartMedia for the iHeartRadio service and labels' agreements with Nokia for the MixRadio service; and Category C – streaming music video services including YouTube and Vevo. In analyzing comparability, Dr. Rubinfeld considers, consistent with the Judges' approach in the decision on remand in *Webcasting III*, whether the agreements are between (1) willing buyers and sellers that are (2) farthest removed from the influence of the statutory license, but which (3) involve the same or similar parties as the statutory license, and (4) provide the same or similar rights as the statutory license.

Dr. Rubinfeld concludes that the directly licensed agreements between record companies and the Category A set of "on-demand" services are the most appropriate benchmarks for this proceeding, for several reasons. These agreements – representing the majority of directly licensed services – were all struck between willing licensees and licensors. Moreover, because they specify functionality that is not DMCA-compliant, direct licensing was required; this minimized the effect of the statutory shadow because the service could not immediately fall back to the statutory license if an agreement was not reached. As a result, the agreements in Category A are not directly influenced by the existing statutory license rates.

In setting forth his rate proposal based on the Category A set of interactive services, Dr. Rubinfeld provides a series of calculations using contractual and performance data for these services. Dr. Rubinfeld's analysis takes into account and adjusts for quantifiable consideration that is not captured by the rate, the value that consumers place on interactivity, the number of royalty-bearing plays in comparison to statutory services, the differences between independent and major record company deals, and the anticipated growth of statutory and directly-licensed services. This results in a set of per-play rates ranging from $.0025 through $.0029 for the rate period. With respect to the percentage of revenue prong, Dr. Rubinfeld observes that these agreements provide record companies with the minimum revenue share that ranges between 50 percent and 60 percent of the services' revenues (based on the record company's share of total streams), with the majority falling between 55 percent and 60 percent. Dr. Rubinfeld conservatively selects 55% for the percentage of revenue prong.

Dr. Rubinfeld further concludes that the other potential benchmark agreements possess a number of characteristics that make them less suitable as comparable benchmarks. He nonetheless analyzes and explains the appropriate weight and consideration that should be given to the iHeartRadio agreement between iHeartMedia and WMG as well as the streaming video services such as YouTube and Vevo.

Dr. Rubinfeld concludes that his rate proposal based upon the on-demand or "interactive" service agreements, when appropriately adjusted, meets the objectives set forth by the Judges in the Commencement Notice for this proceeding, as well as the principles and critiques of prior analyses put forward by the Judges in prior webcasting proceedings.

Thomas Z. Lys, Ph.D., is the Eric L. Kohler Chair in Accounting and Professor of

Accounting and Information Management at the Kellogg School of Management, Northwestern University. Dr. Lys's testimony supports SoundExchange's rate proposal, including the rate structure, audit, and payment terms.

After analyzing the music streaming agreements of 63 service–label pairs, Dr. Lys concludes that the market evidence overwhelmingly supports a rate structure that pays the greater of (i) the fee calculated under a per-performance rate and (ii) a percentage of the webcaster's revenue. Based on his analysis of the 63 service–label pairs, Dr. Lys also concludes that willing buyers and willing sellers would agree to the following payment terms: payment within 30 days of the end of a monthly reporting period and a monthly 1.5% interest rate applied to any late payments. In addition, Dr. Lys concludes that audit rights are a key to ensuring that stakeholders are compensated correctly and that virtually all private agreements contain such rights. Finally, Dr. Lys proposes an approach, consistent with the approach adopted by the Judges in PSS/Satellite II (Docket No. 2011-1 CRB), to account for the performance of directly-licensed sound recordings or sound recordings that otherwise do not require a license.

David Blackburn, Ph.D., is Vice President for NERA Economic Consulting and is based in NERA's Washington, DC office. Dr. Blackburn has examined the development and behavior of webcasters, particularly those using digital sound recordings pursuant to statutory licenses in the United States. His testimony explains that webcasting has been a vibrant and growing industry and is expected to continue as such. He also observes that webcasters often forego short-run profitability in favor of user and market share growth. Dr. Blackburn also analyzed whether statutory webcasting serves a primarily promotional role for other record label revenue sources, and found little support for that proposition. Rather,

the evidence suggests that statutory webcasting does not increase sales of digital downloads and, in fact, serves to cannibalize industry revenue earned through directly-licensed interactive streaming services.

Daniel McFadden, Ph.D., is Emeritus Professor of Economics at University of California at Berkeley and Presidential Professor of Health Economics at the University of Southern California. Dr. McFadden conducted a conjoint survey to determine the value that future consumers of digital streaming services place on the features of those services. Specifically, Dr. McFadden determined that the value that future consumers place on features that are not available under the statutory license, such as the ability to play tracks on-demand, the ability to listen to tracks "offline" and the ability to skip songs in an unlimited manner, represent only a relatively small proportion of the overall willingness to pay for streaming services. The results of Dr. McFadden's survey confirm the interactivity adjustment Dr. Rubinfeld applies to the on-demand set of benchmark agreements in his calculations of the proposed rates for this proceeding.

III. DESIGNATED TESTIMONY FROM *WEBCASTING III*

George S. Ford, Ph.D., is the President of Applied Economic Studies, a private consulting firm specializing in economic and econometric analysis. SoundExchange designates Dr. George S. Ford's testimony from Docket No. 2009-1 CRB *Webcasting III*. Consistent with 37 C.F.R. § 351.4(b)(2), SoundExchange includes a copy of Dr. Ford's Written Direct Testimony and a transcript of Dr. Ford's trial testimony.

Dr. Ford's testimony supports SoundExchange's rate proposal for ephemeral copies under Section 112(e) of the Copyright Act. Dr. Ford concludes that ephemeral copies clearly have economic value and that, based on economic theory and marketplace evidence, the value of

those ephemeral copies is best expressed as a fixed percentage of the overall royalty rate paid by webcasters for combined activities under Sections 112(e) and 114.

Dated: October 7, 2014

Respectfully submitted,

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PROPOSED RATES AND TERMS OF SOUNDEXCHANGE, INC.

Pursuant to 37 C.F.R. § 351.4(b)(3), SoundExchange, Inc. ("SoundExchange") proposes the rates and terms set forth herein for eligible nonsubscription transmissions and transmissions made by a new subscription service other than a service as defined in 37 C.F.R. § 383.2(h) (collectively, "Webcast Transmissions"), together with the making of ephemeral recordings necessary to facilitate Webcast Transmissions, under the statutory licenses set forth in 17 U.S.C. §§ 112(e) and 114 during the period January 1, 2016 through December 31, 2020.

Pursuant to 37 C.F.R. 351.4(b)(3), SoundExchange reserves the right to revise its proposed rates and terms at any time during the proceeding up to, and including, the filing of its proposed findings of fact and conclusions of law.

I. PROPOSED SETTLEMENT FOR NONCOMMERCIAL EDUCATIONAL WEBCASTERS

On the same day that SoundExchange files these proposed rates and terms with the Copyright Royalty Judges, SoundExchange and College Broadcasters, Inc. ("CBI") are submitting a Joint Motion to Adopt Partial Settlement requesting that the Copyright Royalty Judges adopt certain rates and terms for eligible nonsubscription transmissions made by

noncommercial educational webcasters over the internet, as more specifically provided therein. SoundExchange respectfully requests prompt adoption by the Copyright Royalty Judges of the proposed regulations appended to the Joint Motion to Adopt Partial Settlement as the statutory rates and terms for the activities addressed therein.

II. OTHER ROYALTY RATES

For all Webcast Transmissions and related ephemeral recordings not covered by its settlement with CBI, SoundExchange requests royalty rates as set forth below.

A. Commercial Webcasters

1. Minimum Fee

Pursuant to 17 U.S.C. §§ 112(e)(3) and (4) and 114 (f)(2)(A) and (B), SoundExchange requests that all licensees (as defined in 37 C.F.R. § 380.2 of the attached proposed regulations) that are commercial webcasters (defined in the same) pay an annual, nonrefundable minimum fee of $500.00 for each calendar year or part of a calendar year of the license period during which they are licensees, for each individual channel and each individual station (including any side channel maintained by a broadcaster that is a licensee) subject to an annual cap of $50,000.00 for a licensee with 100 or more channels or stations. For each licensee, the annual minimum fee described in this paragraph shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B). Upon payment of the minimum fee, a licensee would receive a credit in the amount of the minimum fee against any royalties payable for the same calendar year.

2. Royalty Rates

For Webcast Transmissions and related ephemeral recordings by commercial webcasters as defined in 37 C.F.R. § 380.2, SoundExchange requests commercial webcasters pay royalties equal to the greater of the following (on an annual basis, as provided below):

(a) 55% of Attributable Revenue from activities in the United States (as defined in 17 U.S.C. § 101).

(b) A usage-based royalty computed on a per-performances basis, as follows:

YEAR	PER PERFORMANCE
2016	$0.0025
2017	$0.0026
2018	$0.0027
2019	$0.0028
2020	$0.0029

True-Up For Greater Of Royalties: In making monthly payments, a commercial webcaster subject to the above greater-of royalties shall, at the time a payment is due, calculate its liability for the year through the end of the applicable month under all relevant subparts of the royalty calculation, and pay the applicable royalty fee for the year through the end of the applicable month, less any amounts previously paid for such year.

Directly-Licensed and Not Licensed Adjustment. Under this proposal, licensees would not be required to pay for royalties attributable to performances that are pursuant to a direct license or that otherwise do not require a license. With respect to the "Attributable Revenue" calculation, the royalty obligations of a licensee would be adjusted based on the percentage of the performances that are made pursuant to the statutory license under 17 U.S.C. § 114, as opposed to performances pursuant to a direct license with the copyright owner or performances that otherwise do not require a license under 17 U.S.C. § 114. The per-performance rate only applies to performances of sound recordings made pursuant to 17 U.S.C. § 114.

B. Noncommercial Webcasters

1. Minimum Fee

Pursuant to 17 U.S.C. §§ 112(e)(3) and (4) and 114 (f)(2)(A) and (B), SoundExchange requests that all licensees (as defined in 37 C.F.R. § 380.2 of the proposed regulations) that are noncommercial webcasters (as defined in the same) pay an annual, nonrefundable minimum fee of $500.00 for each calendar year or part of a calendar year of the license period during which they are licensees, for each individual channel and each individual station (including any side channel maintained by a broadcaster that is a licensee, if not covered by SoundExchange's proposed settlement with CBI). For each licensee, the annual minimum fee described in this paragraph shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B). Upon payment of the minimum fee, a licensee would receive a credit in the amount of the minimum fee against any royalty payable for the same calendar year.

2. Royalty Rates

For Webcast Transmissions and related ephemeral recordings by noncommercial webcasters as defined in 37 C.F.R. § 380.2, SoundExchange requests that for all Webcast Transmissions totaling not more than 159,140 aggregate tuning hours in a month, a noncommercial webcaster pay an annual per station or per channel performance royalty of $500 in 2016 through 2020. Also, SoundExchange requests that if, in any month, a noncommercial webcaster makes total transmissions in excess of 159,140 aggregate tuning hours (as defined in 37 C.F.R. § 380.2) on any individual channel or station, the noncommercial webcaster shall pay per-performance royalty fees for the transmissions it makes on that channel or station in excess of 159,140 aggregated tuning hours at the following rates:

YEAR	PER PERFORMANCE
2016	$0.0025
2017	$0.0026
2018	$0.0027
2019	$0.0028
2020	$0.0029

C. Ephemeral Recordings

SoundExchange requests that the royalty payable under 17 U.S.C. § 112(e) for the making of ephemeral recordings used by the licensee solely to facilitate transmissions for which it pays royalties as provided above shall be included within, and constitute 5% of, such royalty payments.

III. TERMS

SoundExchange requests that the terms currently set forth in 37 C.F.R. Part 380, Subpart A be continued, subject to the changes described herein.

A. Payment Term Reduced to 30 Days

SoundExchange requests that the current 45-day "monthly payment" requirement reflected in 37 C.F.R. § 380.4(c) be reduced to a 30-day requirement. As described in the testimony of Dr. Lys and Mr. Bender, this change is supported by market evidence and will expedite the royalty distribution process for artists and copyright owners, potentially allowing the distribution of royalties a full month earlier than at present. Notably, if the Judges grant this request, the similar requirements for statements of account and reports of use should also be reduced to 30 days.

B. "Qualified Auditor" Definition

SoundExchange requests a revision of the definition of a "Qualified Auditor" in 37 C.F.R. § 380.2 to permit the use of an auditor who has experience that would be useful in the audit of music streaming services, regardless of whether the auditor is a Certified Public Accountant or not. Notably, SoundExchange's requested change would not deny the use of a Certified Public Account by a party who elected for the same. Rather, the change would expand the available options of auditors to include those who have demonstrated recent experience in an area that often requires specialized information, as reflected in the testimony of Mr. Wilcox.

C. Acceptable Verification Procedure

SoundExchange requests that the Judges eliminate the acceptable verification procedure requirement currently reflected in 37 C.F.R. § 380.6(e). The current requirement does not distinguish between audits concerning purely financial metrics and audits that analyze the usage and performance metrics that are important in the context of Section 114 licensees. As noted in the testimony of Mr. Wilcox, royalty or performance-based audits of music streaming services are different in nature than financial audits, including financial audits of those same music streaming services.

IV. PROPOSED REGULATIONS

SoundExchange has attached proposed regulations implementing the foregoing requested rates and terms, including certain technical and conforming changes. The proposed regulations are marked to show changes from the regulations currently in 37 C.F.R. Part 380, Subpart A.

SoundExchange is not proposing any separate rates and terms for commercial broadcasters, as distinct from other licensees, and therefore requests that 37 C.F.R. Part 380, Subpart B be stricken in its entirety. SoundExchange proposes that 37 C.F.R. Part 380, Subpart C be continued, but modified as provided in the CBI settlement.

Dated: October 7, 2014

Respectfully submitted,

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ATTACHMENT

PROPOSED REGULATIONS

SoundExchange proposes that the provisions of 37 C.F.R. Part 380 Subpart A continue in effect except as modified below. (**~~Bold strikethrough~~** indicates language to be deleted and **bold underline** indicates language to be added.).

Subpart A—Commercial Webcasters and Noncommercial Webcasters

§ 380.1 General.

(a) *Scope*. This subpart establishes rates and terms of royalty payments for the public performance of sound recordings in certain digital transmissions by Licensees as set forth in this subpart in accordance with the provisions of 17 U.S.C. 114, and the making of Ephemeral Recordings by Licensees in accordance with the provisions of 17 U.S.C. 112(e), during the period January 1, **~~2011~~2016**, through December 31, **~~2015~~2020**.

(b) *Legal compliance*. Licensees relying upon the statutory licenses set forth in 17 U.S.C. 112(e) and 114 shall comply with the requirements of those sections, the rates and terms of this subpart, and any other applicable regulations.

(c) *Relationship to voluntary agreements*. Notwithstanding the royalty rates and terms established in this subpart, the rates and terms of any license agreements entered into by Copyright Owners and Licensees shall apply in lieu of the rates and terms of this subpart to transmission within the scope of such agreements.

§ 380.2 Definitions.

For purposes of this subpart, the following definitions shall apply:

Aggregate Tuning Hours (ATH) means the total hours of programming that the Licensee has transmitted during the relevant period to all listeners within the United States from all channels and stations that provide audio programming consisting, in whole or in part, of eligible nonsubscription transmissions or noninteractive digital audio transmissions as part of a new subscription service, less the actual running time of any sound recordings for which the Licensee has obtained direct licenses apart from 17 U.S.C. 114(d)(2) or which do not require a license under United States copyright law. By way of example, if a service transmitted one hour of programming to 10 simultaneous listeners, the service's Aggregate Tuning Hours would equal 10. If 3 minutes of that hour consisted of transmission of a directly licensed recording, the service's Aggregate Tuning Hours would equal 9 hours and 30 minutes. As an additional example, if one listener listened to a service for 10 hours (and none of the recordings transmitted during that time was directly licensed), the service's Aggregate Tuning Hours would equal 10.

Broadcaster is a type of Licensee that owns and operates a terrestrial AM or FM radio station that is licensed by the Federal Communications Commission.

Collective is the collection and distribution organization that is designated by the Copyright Royalty Judges. For the ~~2011-2015~~2016-2020 license period, the Collective is SoundExchange, Inc.

Commercial Webcaster is a Licensee, other than a Noncommercial Webcaster, that makes eligible digital audio transmissions.

Copyright Owners are sound recording copyright owners who are entitled to royalty payments made under this subpart pursuant to the statutory licenses under 17 U.S.C. 112(e) and 114.

Ephemeral Recording is a phonorecord created for the purpose of facilitating a transmission of a public performance of a sound recording under a statutory license in accordance with 17 U.S.C. 114, and subject to the limitations specified in 17 U.S.C. 112(e).

Licensee is a person that has obtained a statutory license under 17 U.S.C. 114, and the implementing regulations, to make eligible nonsubscription transmissions, or noninteractive digital audio transmissions as part of a new subscription service (as defined in 17 U.S.C. 114(j)(8)) other than a Service as defined in § 383.2(h) of this chapter, or that has obtained a statutory license under 17 U.S.C. 112(e), and the implementing regulations, to make Ephemeral Recordings for use in facilitating such transmissions, but that is not—

~~(1) A Broadcaster as defined in § 380.11; or~~

~~(2) A~~ a Noncommercial Educational Webcaster as defined in § 380.21.

Noncommercial Webcaster is a Licensee that makes eligible digital audio transmissions and

(1) Is exempt from taxation under section 501 of the Internal Revenue Code of 1986 (26 U.S.C. 501),

(2) Has applied in good faith to the Internal Revenue Service for exemption from taxation under section 501 of the Internal Revenue Code and has a commercially reasonable expectation that such exemption shall be granted, or

(3) Is operated by a State or possession or any governmental entity or subordinate thereof, or by the United States or District of Columbia, for exclusively public purposes.

Performance is each instance in which any portion of a sound recording is publicly performed to a listener by means of a digital audio transmission (*e.g.,* the delivery of any portion of a single track frVom a compact disc to one listener) but excluding the following:

(1) A performance of a sound recording that does not require a license (*e.g.,* a sound recording that is not copyrighted);

(2) A performance of a sound recording for which the service has previously obtained a license from the Copyright Owner of such sound recording; and

(3) An incidental performance that both:

(i) Makes no more than incidental use of sound recordings including, but not limited to, brief musical transitions in and out of commercials or program segments, brief performances during news, talk and sports programming, brief background performances during disk jockey announcements, brief performances during commercials of sixty seconds or less in duration, or brief performances during sporting or other public events and

(ii) Other than ambient music that is background at a public event, does not contain an entire sound recording and does not feature a particular sound recording of more than thirty seconds (as in the case of a sound recording used as a theme song).

Performers means the independent administrators identified in 17 U.S.C. 114(g)(2)(B) and (C) and the parties identified in 17 U.S.C. 114(g)(2)(D).

Qualified Auditor is a Certified Public Accountant**, or a person, who by virtue of education or experience, is appropriately qualified to perform an audit to verify royalty payments related to performances of sound recordings**.

Side Channel is a channel on the Web site of a Broadcaster which channel transmits eligible transmissions that are not simultaneously transmitted over the air by the Broadcaster.

§ 380.3 Royalty fees for the public performance of sound recordings and for ephemeral recordings.

(a) *Royalty rates*. Royalty rates and fees for eligible digital transmissions of sound recordings made pursuant to 17 U.S.C. 114, and the making of ephemeral recordings pursuant to 17 U.S.C. 112(e) are as follows:

(1) *Commercial Webcasters*: For all digital audio transmissions, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, and related Ephemeral Recordings, a Commercial Webcaster will pay a royalty of **the greater of the following, on an annual basis**: ~~**of: $0.0019 per performance for 2011; $0.0021 per performance for 2012; $0.0021 per performance for 2013; $0.0023 per performance for 2014; and $0.0023 per performance for 2015.**~~

(i) 55% of Attributable Revenue from activities in the United States (as defined in 17 U.S.C. § 101), subject to the adjustment set forth in § 380.3(d)(2) of this chapter;

(ii) $0.0025 per performance for 2016; $0.0026 per performance for 2017; $0.0027 per performance for 2018; $0.0028 per performance for 2019; and $0.0029 per performance for 2020.

(2) *Noncommercial Webcasters*: (i) For all digital audio transmissions totaling not more than 159,140 Aggregate Tuning Hours (ATH) in a month, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, and related Ephemeral Recordings, a Noncommercial Webcaster will pay an annual per channel or per station performance royalty of $500 ~~**in 2011, 2012, 2013, 2014, and 2015**~~.

(ii) For all digital audio transmissions totaling in excess of 159,140 Aggregate Tuning Hours (ATH) in a month, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, and related Ephemeral Recordings, a Noncommercial Webcaster will pay a royalty of: ~~**$0.0019 per performance for 2011; $0.0021 per performance for 2012; $0.0021 per performance for 2013; $0.0023 per performance for 2014; and $0.0023 per performance for 2015**~~**$0.0025 per performance for 2016; $0.0026 per performance for 2017; $0.0027 per performance for 2018; $0.0028 per performance for 2019; and $0.0029 per performance for 2020**.

(b) *Minimum fee*—(1) *Commercial Webcasters*. Each Commercial Webcaster will pay an annual, nonrefundable minimum fee of $500 for each calendar year or part of a calendar year ~~**of the period 2011-2015**~~ during which it is a Licensee pursuant to 17 U.S.C. 112(e) or 114. This annual minimum fee is payable for each individual channel and each individual station maintained by Commercial Webcasters, and is also payable for each individual Side Channel maintained by Broadcasters who are Commercial Webcasters, provided that a Commercial Webcaster shall not be required to pay more than $50,000 per calendar year in minimum fees in the aggregate (for 100 or more channels or stations). For each such Commercial Webcaster, the annual minimum fee described in this paragraph (b)(1) shall constitute the minimum fees due under both 17 U.S.C. 112(e)(4) and 114(f)(2)(B). Upon payment of the minimum fee, the Commercial Webcaster will receive a credit in the amount of the minimum fee against any additional royalty fees payable in the same calendar year.

(2) *Noncommercial Webcasters*. Each Noncommercial Webcaster will pay an annual, nonrefundable minimum fee of $500 for each calendar year or part of a calendar year ~~**of the period 2011-2015**~~ during which it is a Licensee pursuant to 17 U.S.C. 112(e) or 114. This annual minimum fee is payable for each individual channel and each individual station maintained by Noncommercial Webcasters, and is also payable for each individual Side Channel maintained by Broadcasters who are Noncommercial Webcasters. For each such Noncommercial Webcaster, the annual minimum fee described in this paragraph (b)(2) shall constitute the minimum fees due under both 17 U.S.C. 112(e)(4) and 114(f)(2)(B). Upon payment of the minimum fee, the Noncommercial Webcaster will receive a credit in the amount of the minimum fee against any additional royalty fees payable in the same calendar year.

(c) *Ephemeral recordings*. The royalty payable under 17 U.S.C. 112(e) for the making of all Ephemeral Recordings used by the Licensee solely to facilitate transmissions for which it pays royalties shall be included within, and constitute 5% of, the total royalties payable under 17 U.S.C. 112(e) and 114.

(d) *The Percentage-of-Revenue Fee*

(1) Definitions

(i) *Service* is a service owned, operated, or controlled by a Licensee, that makes make eligible nonsubscription transmissions, or noninteractive digital audio transmissions as part of a new subscription service (as defined in 17 U.S.C. 114(j)(8)) other than a Service as defined in § 383.2(h) of this chapter;

(ii) *Gross Revenue* means all amounts paid, payable, credited, or creditable to Licensee, received or receivable by or on behalf of Licensee, or recognized by Licensee as revenue under United States Generally Accepted Accounting Principles (U.S. GAAP) or Licensee's past practices, from all sources in connection with the provision of a Service in the United States (as defined in 17 U.S.C. § 101), not reduced by bad debt, and including, without limitation, any and all:

(A) Revenue from user fees in connection with the Service, including, without limitation, any access charges, per-stream charges, subscription fees, or other consideration payable to Licensee by or on behalf of users of the Service in connection with the Service;

(B) Revenue from sales of advertising in connection with the Service, including, without limitation, any revenue or fees from banner advertisements, audio advertisements, video advertisements, interstitial advertisements, pre-roll or post-roll advertisements, sponsorships, promotions, referrals, click-through advertisements, or product placements in connection with the Service;

(C) Revenue from sales of products and services offered as part of or through the Service, including revenue from products and services that are Bundled with the Service;

(D) Revenue from any software or other product associated with the Service, including, without limitation, placement fees for such software or other product, revenue from sales of such software or other product, or revenue sharing with the provider of such software or other product.

(E) Fair market value of any non-cash consideration, including, without limitation, any barter arrangement with any customers, vendors or business partners; and

(F) Revenue generated by the use or exploitation of data gathered or generated from the Service.

(iii) *Adjusted Revenue* means Gross Revenue reduced by the following adjustments:

(A) Solely with respect to revenue from sales of products and services offered as part of or through the Service, the wholesale price of the products and services, returns of the products and services, and shipping, credit card, and other service fees related to such products and services, all as actually paid by Licensee to unrelated third persons;

(B) Sales of sound recording products such as CDs or authorized downloads; and

(C) Sales, excise, or use taxes imposed by operation of law and properly paid or scheduled to be paid to the applicable tax authorities.

(iv) *Attributable Revenue* means Adjusted Revenue reduced by Non-Attributable Revenue.

(v) *Non-Attributable Revenue* means:

(A) Where the Service is Bundled with other products or services that do not involve the Service, Non-Attributable Revenue shall mean the portion of Adjusted Revenue attributable to such other products or services that do not involve the Service. Such revenues shall be calculated through a Fair Method of Allocation.

(B) For Licensees that offer terrestrial radio broadcasts, Non-Attributable Revenue shall include the portion of Adjusted Revenue from sales of advertising, sponsorships, promotions, product placements, referrals, and the like that is attributable to terrestrial radio broadcasts. Such revenue shall be calculated through a Fair Method of Allocation.

(vi) *Bundled.* A product or service is Bundled with another product or service where, by contractual terms, technical design, or other mechanism, one product or service is offered or provided to a person only on the condition that the person purchase, receive, accept, or has access to the other product or service.

(vii) *Fair Method of Allocation* means a reasonable method, employed in good faith and in accordance with U.S. GAAP, to allocate revenues:

(A) to the products or services that are Bundled with the Service but that do not involve the Service; or

(B) to terrestrial radio broadcasts.

(2) *Royalty Adjustment for Directly-Licensed and Non-Licensed Recordings.* The royalty calculated under § 380.3(a)(1)(i) of this chapter shall be adjusted to account for the relative percentage of Performances (as defined in § 380.2) made by a Service. To do so, the total of 55% of Attributable Revenue will be multiplied by the following fraction: with respect to digital audio transmissions, the total Performances on a Service divided by the sum of the Performances on the Service, the performances of sound recordings on the Service that do not require a license (i.e. sound recordings that are not copyrighted under federal law), and the performances of sound recordings on the Service for which the Licensee has previously obtained a license from the Copyright Owner of such recording. For example, if a Service makes 85 Performances, 5 performances that do not require a license, and 10 performances for which the Licensee obtained a license directly from the Copyright Owner, then the royalty calculated under § 380.3(a)(1)(i) would be: 55% x Attributable Revenue x [85/100].

(3) *Certification.* Licensee's Chief Financial Officer or, if Licensee does not have a Chief Financial Officer, a person authorized to sign statements of account for the Licensee pursuant to § 380.4(f)(3), shall submit a signed certification on an annual basis attesting that Licensee's royalty statements for the prior year represent a true and accurate determination of the royalties due and that any Fair Method of Allocation employed by Licensee was applied in good faith and in accordance with U.S. GAAP.

(4) *Records*

(i) Licensee shall maintain and keep complete and accurate books and records concerning the Service and all performances and any other transactions, Gross Revenues, Adjusted Revenues, Attributable Revenues, and Non-Attributable Revenues contemplated herein for the prior 3 calendar years.

(ii) To the extent Licensee claims any Non-Attributable Revenues, it shall, for 3 years, maintain sufficient calculations, studies, third party valuation opinions, or internal assumptions used to establish the value of the Non-Attributable Revenues.

§ 380.4 Terms for making payment of royalty fees and statements of account.

(a) *Payment to the Collective.* A Licensee shall make the royalty payments due under § 380.3 to the Collective.

(b) *Designation of the Collective.* (1) Until such time as a new designation is made, SoundExchange, Inc., is designated as the Collective to receive statements of account and royalty payments from Licensees due under § 380.3 and to distribute such royalty payments to each Copyright Owner and Performer, or their designated agents, entitled to receive royalties under 17 U.S.C. 112(e) or 114(g).

(2) If SoundExchange, Inc. should dissolve or cease to be governed by a board consisting of equal numbers of representatives of Copyright Owners and Performers, then it shall be replaced by a successor Collective upon the fulfillment of the requirements set forth in paragraph (b)(2)(i) of this section.

(i) By a majority vote of the nine Copyright Owner representatives and the nine Performer representatives on the SoundExchange board as of the last day preceding the condition precedent in this paragraph (b)(2), such representatives shall file a petition with the Copyright Royalty Judges designating a successor to collect and distribute royalty payments to Copyright Owners and Performers entitled to receive royalties under 17 U.S.C. 112(e) or 114(g) that have themselves authorized the Collective.

(ii) The Copyright Royalty Judges shall publish in the **Federal Register** within 30 days of receipt of a petition filed under paragraph (b)(2)(i) of this section an order designating the Collective named in such petition.

(c) *Monthly payments.* **(1)** A Licensee shall make any payments due under § 380.3 on a monthly basis on or before the **~~45~~30**th day after the end of each month for that month. All monthly payments shall be rounded to the nearest cent.

(2) In making monthly payments pursuant to § 380.3(a)(1), a Commercial Webcaster will, at the time a payment is due, calculate its liability for the year through the end of the applicable month and pay the applicable royalty fee for the year through the end of the applicable month, less any amounts previously paid for such year.

(d) *Minimum payments.* A Licensee shall make any minimum payment due under § 380.3(b) by January 31 of the applicable calendar year, except that payment for a Licensee that has not previously made eligible nonsubscription transmissions, noninteractive digital audio transmissions as part of a new subscription service or Ephemeral Recordings pursuant to the licenses in 17 U.S.C. 114 and/or 17 U.S.C. 112(e) shall be due by the **~~45~~30**th day after the end of the month in which the Licensee commences to do so.

(e) *Late payments and statements of account.* A Licensee shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment and/or statement of account received by the Collective after the due date. Late fees shall accrue from the due date until payment and the related statement of account are received by the Collective.

(f) *Statements of account.* Any payment due under § 380.3 shall be accompanied by a corresponding statement of account. A statement of account shall contain the following information:

(1) Such information as is necessary to calculate the accompanying royalty payment;

(2) The name, address, business title, telephone number, facsimile number (if any), electronic mail address and other contact information of the person to be contacted for information or questions concerning the content of the statement of account;

(3) The ~~handwritten~~ signature of:

(i) The owner of the Licensee or a duly authorized agent of the owner, if the Licensee is not a partnership or corporation;

(ii) A partner or delegee, if the Licensee is a partnership; or

(iii) An officer of the corporation, if the Licensee is a corporation.

(4) The printed or typewritten name of the person signing the statement of account;

(5) The date of signature;

(6) If the Licensee is a partnership or corporation, the title or official position held in the partnership or corporation by the person signing the statement of account;

(7) A certification of the capacity of the person signing; and

(8) A statement to the following effect:

I, the undersigned owner or agent of the Licensee, or officer or partner, have examined this statement of account and hereby state that it is true, accurate, and complete to my knowledge after reasonable due diligence.

(g) *Distribution of royalties.* (1) The Collective shall promptly distribute royalties received from Licensees to Copyright Owners and Performers, or their designated agents, that are entitled to such royalties. The Collective shall only be responsible for making distributions to those Copyright Owners, Performers, or their designated agents who provide the Collective with such information as is necessary to identify the correct recipient. The Collective shall distribute royalties on a basis that values all performances by a Licensee equally based upon the information provided under the reports of use requirements for Licensees contained in § 370.4 of this chapter.

(2) If the Collective is unable to locate a Copyright Owner or Performer entitled to a distribution of royalties under paragraph (g)(1) of the section within 3 years from the date of payment by a Licensee, such royalties shall be handled in accordance with § 380.8.

(h) *Retention of records.* Books and records of a Licensee and of the Collective relating to payments of and distributions of royalties shall be kept for a period of not less than the prior 3 calendar years.

§ 380.5 Confidential Information.

(a) *Definition.* For purposes of this subpart, "Confidential Information" shall include the statements of account and any information contained therein, including the amount of royalty payments, and any information pertaining to the statements of account reasonably designated as confidential by the Licensee submitting the statement.

(b) *Exclusion.* Confidential Information shall not include documents or information that at the time of delivery to the Collective are public knowledge. The party claiming the benefit of this provision shall have the burden of proving that the disclosed information was public knowledge.

(c) *Use of Confidential Information.* In no event shall the Collective use any Confidential Information for any purpose other than royalty collection and distribution and activities related directly thereto.

(d) *Disclosure of Confidential Information.* Access to Confidential Information shall be limited to:

(1) Those employees, agents, attorneys, consultants and independent contractors of the Collective, subject to an appropriate confidentiality agreement, who are engaged in the collection and distribution of royalty payments hereunder and activities related thereto, for the purpose of performing such duties during the ordinary course of their work and who require access to the Confidential Information;

(2) An independent and Qualified Auditor, subject to an appropriate confidentiality agreement, who is authorized to act on behalf of the Collective with respect to verification of a Licensee's statement of account pursuant to § 380.6 or on behalf of a Copyright Owner or Performer with respect to the verification of royalty distributions pursuant to § 380.7;

(3) Copyright Owners and Performers, including their designated agents, whose works have been used under the statutory licenses set forth in 17 U.S.C. 112(e) and 114 by the Licensee whose Confidential Information is being supplied, subject to an appropriate confidentiality agreement, and including those employees, agents, attorneys, consultants and independent contractors of such Copyright Owners and Performers and their designated agents, subject to an appropriate confidentiality agreement, for the purpose of performing their duties during the ordinary course of their work and who require access to the Confidential Information; and

(4) In connection with future proceedings under 17 U.S.C. 112(e) and 114 before the Copyright Royalty Judges, and under an appropriate protective order, attorneys, consultants and other authorized agents of the parties to the proceedings or the courts.

(e) *Safeguarding of Confidential Information.* The Collective and any person identified in paragraph (d) of this section shall implement procedures to safeguard against unauthorized access to or dissemination of any Confidential Information using a reasonable standard of care,

but no less than the same degree of security used to protect Confidential Information or similarly sensitive information belonging to the Collective or person.

§ 380.6 Verification of royalty payments.

(a) *General.* This section prescribes procedures by which the Collective may verify the royalty payments made by a Licensee.

(b) *Frequency of verification.* The Collective may conduct a single audit of a Licensee, upon reasonable notice and during reasonable business hours, during any given calendar year, for any or all of the prior 3 calendar years, but no calendar year shall be subject to audit more than once.

(c) *Notice of intent to audit.* The Collective must file with the Copyright Royalty Judges a notice of intent to audit a particular Licensee, which shall, within 30 days of the filing of the notice, publish in the **Federal Register** a notice announcing such filing. The notification of intent to audit shall be served at the same time on the Licensee to be audited. Any such audit shall be conducted by an independent and Qualified Auditor identified in the notice, and shall be binding on all parties.

(d) *Acquisition and retention of report.* The Licensee shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the audit. The Collective shall retain the report of the verification for a period of not less than 3 years.

~~**(e) Acceptable verification procedure. An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by an independent and Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.**~~

(**ef**) *Consultation.* Before rendering a written report to the Collective, except where the auditor has a reasonable basis to suspect fraud and disclosure would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud, the auditor shall review the tentative written findings of the audit with the appropriate agent or employee of the Licensee being audited in order to remedy any factual errors and clarify any issues relating to the audit; Provided that an appropriate agent or employee of the Licensee reasonably cooperates with the auditor to remedy promptly any factual errors or clarify any issues raised by the audit.

(**fg**) *Costs of the verification procedure.* The Collective shall pay the cost of the verification procedure, unless it is finally determined that there was an underpayment of 10% or more, in which case the Licensee shall, in addition to paying the amount of any underpayment, bear the reasonable costs of the verification procedure.

§ 380.7 Verification of royalty distributions.

(a) *General.* This section prescribes procedures by which any Copyright Owner or Performer may verify the royalty distributions made by the Collective; provided, however, that

nothing contained in this section shall apply to situations where a Copyright Owner or Performer and the Collective have agreed as to proper verification methods.

(b) *Frequency of verification.* A Copyright Owner or Performer may conduct a single audit of the Collective upon reasonable notice and during reasonable business hours, during any given calendar year, for any or all of the prior 3 calendar years, but no calendar year shall be subject to audit more than once.

(c) *Notice of intent to audit.* A Copyright Owner or Performer must file with the Copyright Royalty Judges a notice of intent to audit the Collective, which shall, within 30 days of the filing of the notice, publish in the **Federal Register** a notice announcing such filing. The notification of intent to audit shall be served at the same time on the Collective. Any audit shall be conducted by an independent and Qualified Auditor identified in the notice, and shall be binding on all Copyright Owners and Performers.

(d) *Acquisition and retention of report.* The Collective shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the audit. The Copyright Owner or Performer requesting the verification procedure shall retain the report of the verification for a period of not less than 3 years.

~~**(c) *Acceptable verification procedure.* An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by an independent and Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.**~~

(**ce**) *Consultation.* Before rendering a written report to a Copyright Owner or Performer, except where the auditor has a reasonable basis to suspect fraud and disclosure would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud, the auditor shall review the tentative written findings of the audit with the appropriate agent or employee of the Collective in order to remedy any factual errors and clarify any issues relating to the audit; Provided that the appropriate agent or employee of the Collective reasonably cooperates with the auditor to remedy promptly any factual errors or clarify any issues raised by the audit.

(**fg**) *Costs of the verification procedure.* The Copyright Owner or Performer requesting the verification procedure shall pay the cost of the procedure, unless it is finally determined that there was an underpayment of 10% or more, in which case the Collective shall, in addition to paying the amount of any underpayment, bear the reasonable costs of the verification procedure.

§ 380.8 Unclaimed funds.

If the Collective is unable to identify or locate a Copyright Owner or Performer who is entitled to receive a royalty distribution under this subpart, the Collective shall retain the required payment in a segregated trust account for a period of 3 years from the date of distribution. No claim to such distribution shall be valid after the expiration of the 3-year period. After expiration of this period, the Collective may apply the unclaimed funds to offset any costs

deductible under 17 U.S.C. 114(g)(3). The foregoing shall apply notwithstanding the common law or statutes of any State.

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re **DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)**	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

INDEX OF WITNESS TESTIMONY

WITNESS	TITLE
Dennis Kooker	President, Global Digital Business & U.S. Sales, Sony Music Entertainment
Ron Wilcox	Executive Counsel, Business Affairs, Strategic and Digital Initiatives,Warner Music Group
Aaron Harrison	Senior Vice President, Business & Legal Affairs, Global Digital Business, UMG Recordings, Inc.
Jeffrey S. Harleston	General Counsel & Executive Vice President, Business & Legal Affairs for North America, UMG Recordings, Inc.
Simon Wheeler	Director of Digital, Beggars Group
Darius Van Arman	Co-Founder & Co-Owner, Secretly Group
Fletcher Foster	President, CEO & Founder, Iconic Entertainment Group
Raymond M. Hair, Jr.	International President, American Federation of Musicians of the United States and Canada
Michael Huppe	President & CEO, SoundExchange, Inc.

Jonathan Bender	Chief Operating Officer, SoundExchange, Inc.
Daniel L. Rubinfeld, Ph.D.	Robert L. Bridges Professor of Law and Professor of Economics Emeritus, University of California, Berkeley and Professor of Law, New York University
Thomas Z. Lys, Ph.D.	Eric L. Kohler Chair in Accounting and Professor of Accounting and Information Management, Kellogg School of Management, Northwestern University
David Blackburn, Ph.D.	Microeconomist and Vice President for NERA Economic Consulting
Daniel L. McFadden, Ph.D.	Emeritus Professor of Economics, University of California at Berkeley and Presidential Professor of Health Economics, University of Southern California

Designated Testimony from *Webcasting III*	
Dr. George Ford	President, Applied Economic Studies

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

PUBLIC VERSION

INDEX OF SOUNDEXCHANGE EXHIBITS

EXHIBIT NO.	SPONSORING WITNESS	DESCRIPTION	RESTRICTED/ PUBLIC
SX EX. 001-DR	Ron Wilcox	Exhibit 1 - Trial and Experimental Internet Simulcast and Webcasting Agreement with Clear Channel Communications, Inc. dated October 1, 2013	RESTRICTED
SX EX. 002-DR	Ron Wilcox	Exhibit 2 - First Amendment to Trial and Experimental Internet Simulcast and Webcasting Agreement with Clear Channel Communications, Inc. dated March 31, 2014	RESTRICTED
SX EX. 003-DR	Aaron Harrison	Exhibit 1 - New Partner Questionnaire	RESTRICTED
SX EX. 004-DR	Aaron Harrison	[redacted]	RESTRICTED

SX EX. 005-DR	Aaron Harrison	[redacted]	RESTRICTED
SX EX. 006-DR	Aaron Harrison	[redacted]	RESTRICTED
SX EX. 007-DR	Darius Van Arman	Exhibit 1 - Offer Term Sheet	RESTRICTED
SX EX. 008-DP	Michael Huppe	Exhibit 1 - SoundExchange Operations Infographic	PUBLIC
SX EX. 009-DP	Daniel Rubinfeld	Exhibit 1 - Music Revenue by Format 1982-2013	PUBLIC
SX EX. 010-DP	Daniel Rubinfeld	Exhibit 2 – Timeline for Major Entry Events	PUBLIC
SX EX. 011-DP	Daniel Rubinfeld	Exhibit 3 - Year-Over-Year Percentage Change in Inflation-Adjusted Streaming and Total Music Revenue 2005-2013	PUBLIC
SX EX. 012-DP	Daniel Rubinfeld	Exhibit 4 - Pandora Internet Radio Share Over Time	PUBLIC
SX EX. 013-DP	Daniel Rubinfeld	Exhibit 5 - Comparison of Subscription Services Pricing	PUBLIC
SX EX. 014-DP	Daniel Rubinfeld	Exhibit 6 - Percent of Individuals (Age 12+) Who Listened in Last Month	PUBLIC
SX EX. 015-DR	Daniel Rubinfeld	Exhibit 7a – Pandora Users Prefer Ad-Supported Streaming over Paid Subscriptions	RESTRICTED
SX EX. 016-DR	Daniel Rubinfeld	Exhibit 7b – Global Spotify Users Prefer Ad-Supported Streaming over Paid Subscriptions	RESTRICTED
SX EX. 017-DR	Daniel Rubinfeld	Exhibit 7c – U.S. Consumers Prefer Ad-Supported Streaming over Paid Subscriptions	RESTRICTED

SX EX. 018-DP	Daniel Rubinfeld	Exhibit 8 - Commercials Are a Fair Price to Pay for Free Internet Audio	PUBLIC
SX EX. 019-DP	Daniel Rubinfeld	Exhibit 9 - Listeners Consider Internet Audio Sound Quality Better than AM/FM Radio	PUBLIC
SX EX. 020-DP	Daniel Rubinfeld	Exhibit 10 - Internet Audio Commercials Considered Less Plentiful, Less Intrusive, and Less Relevant Than AM/FM Commercials	PUBLIC
SX EX. 021-DP	Daniel Rubinfeld	Exhibit 11 - Number of Webcasters and "Entrants" Paying Royalties Through SoundExchange by Year	PUBLIC
SX EX. 022-DR	Daniel Rubinfeld	Exhibit 12 - iHeartMedia/Warner Minimum Per Play Rate and Minimum Revenue Share Increases	RESTRICTED
SX EX. 023-DR	Daniel Rubinfeld	Exhibit 13 - YouTube Effective Per Play Rates Versus Other Services June 2013 - May 2014	RESTRICTED
SX EX. 024-DP	Daniel Rubinfeld	Exhibit 14 - Analysis of Buyers' Willingness to Pay All Respondents, Weighted by U.S. Users (Future)	PUBLIC
SX EX. 025-DR	Daniel Rubinfeld	Exhibit 15a - Calculation of Plays Per Hour Adjustment Ratio	RESTRICTED
SX EX. 026-DR	Daniel Rubinfeld	Exhibit 15b - Estimation of Pandora's Streams Per Hour	RESTRICTED
SX EX. 027-DR	Daniel Rubinfeld	Exhibit 16a - Range of Adjusted Interactive Benchmark Rates June 2013 - May 2014	RESTRICTED
SX EX. 028-DR	Daniel Rubinfeld	Exhibit 16b - Range of Adjusted Minimum Per Play Rates June 2013 - May 2014	RESTRICTED
SX EX. 029-DR	Daniel Rubinfeld	Exhibit 16c - Range of Adjusted Effective Per Play Rates June 2013 - May 2014	RESTRICTED

SX EX. 030-DR	Daniel Rubinfeld	Exhibit 17 - Detailed Adjustments to YouTube Effective Rates June 2013 - May 2014	RESTRICTED
SX EX. 031-DR	Daniel Rubinfeld	Appendix 1a - Category A Benchmark Analysis	RESTRICTED
SX EX. 032-DR	Daniel Rubinfeld	Appendix 1b - iHeartMedia/Warner Agreement Analysis	RESTRICTED
SX EX. 033-DR	Daniel Rubinfeld	Appendix 1c - Category C Benchmark Analysis	RESTRICTED
SX EX. 034-DR	Daniel Rubinfeld	Appendix 1d - Summary of Advertising Provisions	RESTRICTED
SX EX. 035-DR	Daniel Rubinfeld	Appendix 1e - Majors' Shares of Plays - Category A Service Products that Include On-Demand Functionality June 2013 - May 2014	RESTRICTED
SX EX. 036-DR	Daniel Rubinfeld	Appendix 1f - List of Category A Products Included in Minimum Per Play Rate Computation (Includes On-Demand Functionality and Minimum Per Play Rate)	RESTRICTED
SX EX. 037-DR	Daniel Rubinfeld	Appendix 2 - List of Reviewed Agreements	RESTRICTED

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
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In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

DECLARATION AND CERTIFICATION OF GLENN D. POMERANTZ REGARDING RESTRICTED INFORMATION

1. I am counsel for SoundExchange, Inc. ("SoundExchange") in Docket No. 14-CRB-0001-WR (2016-2020). I respectfully submit this declaration and accompanying Redaction Log (Attachment A) to comply with the Interim Protective Order, dated October 2, 2014, which directs the parties to redact proposed restricted material in the unrestricted versions of their written direct statements and to provide a log of the same redactions. I am authorized by SoundExchange to submit this declaration on its behalf.

2. I have reviewed SoundExchange's written direct statement, witness statements, designated testimony, exhibits, and redaction log, all of which are being submitted in this proceeding on October 7, 2014. I also have reviewed the definitions and terms provided in the Joint Motion to Adopt Protective Order, submitted by SoundExchange on September 23, 2014. After consultation with my client, I have determined that portions of SoundExchange's written direct statement, witness statements, and accompanying exhibits contain information that is "Protected Material" as defined by the proposed Protective Order and that should be treated as "confidential information" under 17 U.S.C. § 803(c)(5). SoundExchange's Written Direct

Statement Redaction Log (Attachment A) identifies the Protected Material and describes the basis for each redaction. The Protected Material is shaded in the printed copies of the restricted versions of SoundExchange's filed materials, and is further described below.

3. The Protected Material that SoundExchange is submitting includes, among other things, confidential testimony and exhibits relating to or constituting (a) contracts, contract terms or negotiation strategies that are proprietary, not available to the public, commercially sensitive, and/or subject to express confidentiality obligations in agreements with third parties; and (b) internal business information, financial data and projections, and competitive strategy that are proprietary, not available to the public, and commercially sensitive.

4. The public disclosure of the Protected Material that SoundExchange is submitting would be likely to cause significant harm. The disclosure would provide an unfair competitive advantage to competitors and/or current or future negotiating counterparties of those whose information would be disclosed. Many but not all competitors and counterparties also are parties to this proceeding. Public disclosure of this information also would place SoundExchange, the entities whose interests it represents and their business partners, and other entities at a significant commercial disadvantage and would pose serious risk to their business interests and strategies.

5. As summarized below, the following witnesses' written direct statements and/or exhibits thereto contain commercial and/or financial information that is proprietary, not known to the public, and commercially sensitive. SoundExchange's specific redactions are described in more detail in Attachment A hereto.

(a) Dennis Kooker's testimony contains competitively sensitive information that is not publicly known regarding Sony Music Entertainment's costs, revenues, business

strategy, negotiation strategy, and agreements with third parties. Disclosure of this information would place Sony Music Entertainment at a disadvantage in future negotiations with streaming services or other service providers, artists, and/or other third-party business partners. Mr. Kooker's testimony also contains third-party research data provided pursuant to contractual confidentiality provisions. Disclosure of such research data provided under confidentiality obligations threatens to undermine the value of such information and the prospect that third parties would agree to prepare or provide such information in the future.

(b) Ron Wilcox's testimony and exhibits contain competitively sensitive information that is not known to the public regarding Warner Music Group's ("Warner") negotiation strategy, key terms that Warner seeks in negotiating agreements for the use of its content, and terms of Warner's confidential agreements. Disclosure of this information would place Warner at an unfair disadvantage in future negotiations and also threatens to place Warner's counter-parties at a similar disadvantage in their future negotiations with existing or prospective business partners.

(c) Aaron Harrison's testimony and exhibits contain competitively sensitive information that is not known to the public regarding UMG Recordings, Inc.'s ("Universal's) negotiating strategy, the terms of its confidential agreements, its advertising rates, and its revenues and costs. His testimony also includes confidential data regarding the performance and sales of Universal's partners. Disclosure of this information would place Universal and its partners at an unfair disadvantage in the marketplace.

(d) Jeffrey Harleston's testimony contains competitively sensitive information regarding Universal's investments in its artists and recordings, the market consideration it receives from digital services, and the costs Universal bears in marketing and developing artists. Disclosure of this business information to its competitors would place Universal at an unfair disadvantage in the marketplace.

(e) Simon Wheeler's testimony contains competitively sensitive information regarding the confidential deals that Beggars Group has entered into with streaming services, its negotiating strategy, financial information regarding its costs, and information from internal analyses of confidential usage data. Disclosure of this information would provide an advantage to Beggars Group's competitors and counter-parties in future business negotiations.

(f) Darius Van Arman's testimony contains the terms of an existing confidential agreement and proposed terms of a potential confidential agreement between Secretly Group and a streaming service that, if disclosed, could place Secretly Group, the service, or both, at a competitive disadvantage. Mr. Van Arman also sponsors an exhibit that contains the confidential proposed terms.

(g) Dr. Thomas Lys's testimony and report involve an analysis and discussion of certain terms in agreements between rights owners and streaming services that are confidential and not publicly known. Disclosure of this information would place the parties involved at a competitive disadvantage with respect to their current or future negotiating counter-parties by disclosing terms to which the parties involved have been willing to agree. Dr. Lys's testimony also includes an appendix that discloses the existence

of certain confidential agreements between content owners and services. Disclosure of the existence of these agreements would place the parties involved at a competitive disadvantage by disclosing whether and how they operate pursuant to licenses.

(h) Dr. Daniel Rubinfeld's testimony and exhibits involve an analysis and discussion of the rates and terms contained in agreements between streaming services and labels that are confidential and not known to the public. Dr. Rubinfeld's report also includes confidential financial data regarding the royalties paid by numerous streaming services. Disclosure of this information would place the parties involved at a competitive disadvantage with respect to their current and prospective counter-parties by disclosing terms and rates to which they have been willing to agree. The report also contains performance data that would place service providers and content owners at a competitive disadvantage if disclosed. Dr. Rubinfeld also sponsors an exhibit that contains third-party research data that was obtained pursuant to contractual confidentiality provisions. Disclosure of such research data provided under confidentiality obligations threatens to undermine the value of such information and the prospect that third parties would agree to prepare or provide such information in the future.

(i) Dr. David Blackburn's testimony contains financial information regarding the total and relative amounts paid by certain statutory webcasters as royalties. Disclosure of this information would place those webcasters at an unfair disadvantage with respect to their competitors as well as in future negotiations with content owners. Dr. Blackburn's testimony also contains third-party research data that was obtained pursuant to contractual confidentiality provisions. Disclosure of such research data provided under confidentiality

obligations threatens to undermine the value of such information and the prospect that third parties would agree to prepare or provide such information in the future.

6. The commercial and financial information from the written direct statement, designated testimony, and exhibits detailed above is proprietary, not known to the public, and commercially sensitive. SoundExchange respectfully submits that this information can and should be treated as "Protected Material" in order to prevent business and competitive harm that would result from the disclosure of such information. At the same time, "Protected Material" treatment will enable SoundExchange to provide the Copyright Royalty Board with the most complete record possible on which to base its determination in this proceeding.

7. A limited subset of competitively sensitive information has been redacted even from SoundExchange's "Restricted" submissions. This is because shortly before the filing of written direct statements SoundExchange received objection to the disclosure of such information by the related service. Unfortunately, SoundExchange has not been able to resolve these disputes but continues to attempt to do so. SoundExchange hopes to share this important but sensitive information with the Judges, and will be happy to file corrected testimony either upon resolution of the dispute or upon order of the Judges to disclose the information.

Pursuant to 28 U.S.C. § 1746 and 37 C.F.R. § 350.4(e)(1), I hereby declare under the penalty of perjury that, to the best of my knowledge, information and belief, the foregoing is true and correct.

Dated: October 6, 2014

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Counsel for SoundExchange, Inc.

ATTACHMENT A

SoundExchange's Written Direct Statement Redaction Log

SoundExchange Witness	Paragraph/Exhibit	Description and Basis for Redaction
Dennis Kooker	p. 4 ¶ 1, p. 4 ¶ 2, p. 4 ¶ 3 , p. 5 ¶ 1, p. 9 ¶ 1	Restricted financial information regarding Sony Music Entertainment's ("Sony Music's") investments and costs with respect to talent, recordings, manufacturing, digital distribution, and marketing. Such information is confidential, proprietary, and commercially sensitive. The disclosure of such information would place Sony Music at a competitive disadvantage.
	p. 8 ¶ 3 (two redactions), p. 8 ¶ 5 (six redactions), p. 12 ¶ 2 (three redactions)	Restricted financial information regarding Sony Music's revenues from physical products and digital recorded music. Such information is confidential, proprietary, and commercially sensitive. The disclosure of such information would place Sony Music at a competitive disadvantage.
	p. 10 ¶ 1	Restricted information concerning Sony Music's employee headcount. Such information is confidential, proprietary, and commercially sensitive. The disclosure of such information would place Sony Music at a competitive disadvantage.
	p. 11 ¶ 1	Restricted information consisting of proprietary data provided by a third party on a confidential basis. Public disclosure of this information would destroy its economic value to the provider and undermine the incentives for gathering such data in the future.

	p. 21 ¶ 3, p. 21 ¶ 4 (two redactions), p. 22 ¶ 1	Restricted information regarding Sony Music's negotiating strategy, business objectives, and agreement terms. Public disclosure of such information would place Sony Music at a competitive disadvantage.
Ron Wilcox	p. 6 ¶ 2 (four redactions), p. 6 ¶ 3 (two redactions), p. 12 ¶ 4, p. 12 ¶ 5, p. 13 ¶ 2, p. 13 ¶ 3, p. 13 ¶ 4 (2 redactions)	Restricted information regarding Warner Music Group's ("Warner") negotiating strategy practices and the structure and terms of its confidential agreements that. Public disclosure of such information would place Warner at a competitive disadvantage.
	p. 9 ¶ 3 (three redactions), p. 9 ¶ 4 (two redactions), p. 10 ¶ 2 (six redactions), p. 10 ¶ 3 (four redactions), p. 11 ¶ 2 (four redactions), p. 11 ¶ 3 (three redactions), p. 12 ¶ 2 (two redactions), p. 12 ¶ 3	Restricted information concerning the terms of a confidential agreement between Warner and iHeartMedia. Public disclosure would place Warner, iHeartMedia, or both, at a competitive disadvantage.
	Wilcox Exs. 1 – 2	Restricted information consisting of confidential agreements between Warner and iHeartMedia. Public disclosure would place Warner, iHeartMedia, or both, at a competitive disadvantage.
Aaron Harrison	¶ 8 (four redactions)	Restricted financial information regarding UMG Recordings, Inc.'s ("Universal's") revenues from Apple iTunes download sales. Public disclosure would place Universal, Apple, or both at a competitive disadvantage.
	¶ 13 (nine redactions), ¶ 27 (two redactions), ¶ 29 (three redactions), ¶ 30 (three redactions), ¶ 31 (ninth redaction), ¶ 33 (five redactions), ¶ 37, ¶ 38, ¶ 39	Restricted information concerning the terms of confidential agreements between Universal and multiple streaming services. Public disclosure of such information could place Universal, the services, or all of them,

	(first redaction), ¶ 43 (second redaction) , ¶ 50 (two redactions), ¶ 51, ¶ 52 (three redactions) Harrison Exs. 2 – 4	at a competitive disadvantage.
	¶ 15 (four redactions)	Restricted information disclosing confidential revenue information that Universal receives from subscription services. Public disclosure would place Universal at a competitive disadvantage.
	¶ 16 (three redactions), ¶ 32	Restricted information consisting of specific confidential details regarding Universal's revenues and expenditures. Public disclosure would place Universal at a competitive disadvantage.
	¶ 19, ¶ 20	Restricted information regarding the identities of counter-parties that engaged in confidential negotiations with Universal and information that would reveal positions taken by the parties during confidential negotiations. Disclosure of this information would place Universal and/or the counter-parties at a competitive disadvantage.
	¶ 31 (first 8 redactions), ¶ 42, ¶ 43 (first redaction), Harrison Ex. 1.	Restricted information consisting of Universal's confidential negotiation positions, processes, strategies, and goals. Public disclosure would place Universal at a competitive disadvantage.
	¶ 34	Restricted information concerning a streaming service's performance under an agreement with Universal and terms of a confidential agreement between that service and Universal. Public disclosure would place Universal, the streaming service, or both, at a competitive disadvantage.

	¶ 39 (second redaction)	Restricted information concerning a streaming service's confidential rates for advertising that, if disclosed would place that service at a competitive disadvantage.
	¶ 45 (three redactions)	Restricted information concerning the terms of a confidential agreement between Universal and a partner that, if disclosed, could place Universal Music Group, a partner, or both, at a competitive disadvantage.
Jeffrey S. Harleston	¶ 11	Restricted information concerning amounts that Universal spent on talent and product development in 2013. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Universal at a competitive disadvantage.
	¶ 13	Restricted information concerning the amounts that Universal invested in advances for new artist signings and write offs from established artists in 2013. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Universal at a competitive disadvantage.
	¶ 20	Restricted information concerning the amounts that Universal spends in pre-release costs for new artists. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Universal at a competitive disadvantage.
	¶ 21	Restricted information concerning the amounts Universal spends in pre-release costs for established artists. Such information is confidential,

		proprietary and competitively sensitive. Public disclosure would place Universal at a competitive disadvantage.
	¶ 27	Restricted information consisting of competitively sensitive information regarding marketing consideration Universal Music Group has received from digital services. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Universal, the services, or all of them at a competitive disadvantage.
	¶ 30 (two redactions)	Restricted information concerning the amounts Universal Music Group spent in marketing costs and overhead in 2013. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Universal at a competitive disadvantage.
	¶ 31	Restricted information concerning the amounts Universal Music Group paid to third parties in manufacturing costs for physical records in 2013. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Universal at a competitive disadvantage.
	¶ 32	Restricted information concerning the amounts Universal has invested in IT infrastructure and operating costs for efficient digital distribution. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Universal at a competitive disadvantage.
Simon Wheeler	¶ 8 (two redactions)	Restricted information consisting of confidential and competitively

		sensitive information regarding the number of deals Beggars Group has with digital services and the number of deals with streaming services in particular. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Beggars Group, the services, or all of them at a competitive disadvantage.
	¶ 12	Restricted financial information regarding the costs for an independent label operating a digital supply chain. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Beggars Group at a competitive disadvantage.
	¶ 19, ¶ 21, ¶ 22, ¶ 23	Restricted information consisting of Beggars Group's negotiation positions, strategy, and goals that. Public disclosure would place Beggars Group at a competitive disadvantage.
	¶ 28 (three redactions)	Restricted information consisting of Beggars Group's confidential financial information, including the proportion of revenues from digital streaming services and the relative importance of streaming services versus sales or downloads to Beggars Group's revenues. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place Beggars Group at a competitive disadvantage.
	¶ 32	Restricted information from Beggars Group reflecting internal analysis using confidential usage data. Such information is confidential, proprietary and competitively sensitive. Public disclosure would

		place Beggars Group at a competitive disadvantage.
Darius Van Arman	p. 16 ¶ 2 (three redactions)	Restricted information consisting of competitively sensitive business information, including the terms of an existing agreement and proposed terms for a new agreement between Secretly Group and a streaming service that, if disclosed, could place Secretly Group, the service, or both, at a competitive disadvantage.
	Van Arman Ex. 1	Restricted information concerning the confidential proposed terms of a potential agreement between Secretly Group and a streaming service that, if disclosed, could place Secretly Group, the streaming service, or both, at a competitive disadvantage.
Daniel L. Rubinfeld, Ph.D.	¶ 23 (two redactions), ¶ 24 (three redactions), ¶ 150, ¶ 162 (first redaction), ¶ 177, ¶ 178, ¶ 179, ¶ 180, ¶ 183, ¶ 184, ¶ 185, ¶ 186(c), ¶ 186(d), section heading VI.B.1.(1), section heading VI.B.1.(2), ¶ 229, ¶ 230, ¶ 231, ¶ 232, ¶ 233, footnote 110, footnote 112, footnote 113, footnote 133, footnote 134, footnote 135, footnote 136 , Exhibit 12 Appendix 1b	Restricted information concerning the terms of a confidential agreement between Warner and iHeartMedia that, if disclosed, would place Warner, iHeartMedia, or both, competitive disadvantage.
	¶ 25, ¶ 190 (two redactions), ¶ 191(c), ¶ 192, ¶ 237 (two redactions),	Restricted information concerning the terms of confidential agreements entered into between certain content owners and Nokia that, if disclosed,

	¶ 238, footnote 114,footnote 116	would place Nokia, the content owners, or both at a competitive disadvantage.
	¶ 27, ¶ 84 (two redactions), ¶ 115, ¶ 131, ¶ 139, ¶ 162 (second redaction) ¶ 164, ¶ 165, ¶ 173 ¶ 174(d), ¶ 218 (two redactions), ¶ 221 (two redactions), footnote 70, footnote 102, footnote 107, footnote 108, footnote 109, footnote 129, footnote 130	Restricted information concerning the terms of confidential agreements that, if disclosed, would place the parties to the agreements at a competitive disadvantage.
	¶ 195, ¶ 241, ¶ 242	Restricted information concerning the terms of confidential agreements entered into between certain content owners and YouTube. Disclosure of this information would place YouTube, the content owners, or both at a competitive disadvantage.
	¶ 236 (table) ¶ 244 (table), Exhibit 13, Exhibit 15, Exhibit 16, Exhibit 17, Appendix 1a Appendix 1c	Restricted information concerning the total royalties, royalty rates or relative royalty rates paid by certain service providers pursuant to confidential agreements. Such information is confidential, proprietary and competitively sensitive. Public disclosure would place the service providers, content owners, or all of them, at a competitive disadvantage.
	Appendix 1d, Appendix 1f	Restricted information concerning the terms of confidential agreements entered into between content owners and service providers that, if disclosed, would place these service providers, content owners, or both, at a competitive disadvantage.

	Appendix 1e	Restricted information concerning confidential performance data from service providers that, if disclosed, would place these service providers, content owners, or both, at a competitive disadvantage.
	¶ 250(b)	Restricted information concerning the terms of a confidential agreement and the amounts paid pursuant to that agreement that, if disclosed, would place the parties to the agreement at a competitive disadvantage.
	Exhibit 7	Restricted information consisting of proprietary data provided by a third party on a confidential basis. Public disclosure of this information would destroy its economic value to the provider and undermine the incentives for gathering such data in the future.
	Appendix 2	Restricted information disclosing the existence of confidential and competitively sensitive agreements between specific content owners and specific service providers. Disclosure of this information would place certain content owners, certain service providers, or all of them at a competitive disadvantage.
Thomas Z. Lys, Ph.D.	¶ 29 (two redactions), ¶ 33, ¶ 34 (two redactions), footnote 6, footnote 7 (two redactions)	Restricted information concerning the identities of services that entered into confidential agreements that do not contain a greater-of provision for the calculation of royalties. Disclosure of this information would place all parties involved at a competitive disadvantage.
	¶ 32, Figure 2 (p. 6), Figure 3 (p. 7)	Restricted information regarding an analysis of the prevalence of label-service agreements containing a

		"greater-of" structure that, if disclosed, would place the parties involved at a competitive disadvantage.
	¶ 62 (four redactions)	Restricted information concerning the identities of the parties to a confidential private agreement providing a label with an equity stake in a service and the terms of that agreement. Disclosure of this information would place the parties involved at a competitive disadvantage.
	Appendix B	Restricted information disclosing the existence of confidential and competitively sensitive agreements between particular content owners and particular service providers. Disclosure of this information would place the content owners, the service providers, or all of them at a competitive disadvantage by disclosing whether and how they operate pursuant to contractual licenses.
David Blackburn, Ph.D.	¶ 23 (ten redactions), Table 2 (p. 13)	Restricted information concerning (i) the total amount of all royalty payments paid by the top 10 webcasters by royalty payment fees in 2013 and (ii) the amount and relative share of fees paid by each of these webcasters in 2013. Such information is confidential and proprietary. Disclosure of this information would place these webcasters at a competitive disadvantage.
	¶ 44 (two redactions), Figure 10 (p. 34), ¶ 95 (two redactions), Figure 15 (p. 64).	Restricted information consisting of proprietary data provided by a third party on a confidential basis. Public disclosure of this information would destroy its economic value to the

		provider and undermine the incentives for gathering such data in the future.
	¶ 51	Restricted information concerning the portion of 2013 webcasting payments made by Pandora that, if disclosed, would place Pandora and/or other parties at a competitive disadvantage.

SoundExchange's Provisional Redactions Pending Resolution of Confidentiality Dispute

SoundExchange Witness	**Paragraph/Exhibit**	**Description and Basis for Redaction**
Daniel L. Rubinfeld, Ph.D.	¶ 131, ¶ 218 (two redactions), ¶ 250(b)	Provisional redaction of Spotify information pending resolution of dispute described in Paragraph 7 of Pomerantz Declaration.
	¶ 221 (two redactions), footnote 129, footnote 130, Appendix 2	Provisional redaction of Spotify information pending resolution of dispute described in Paragraph 7 of Pomerantz Declaration.
	Rubinfeld Ex. 16a, Appendix 1a, Appendix 1d and footnote 3, Appendix 1e, Appendix 1f, Appendix 2	Provisional redaction of Beats, MOG, and Spotify information pending resolution of dispute described in Paragraph 7 of Pomerantz Declaration.
Thomas Z. Lys, Ph.D.	Figure 3 (three redactions)	Provisional redaction of information pending resolution of dispute described in Paragraph 7 of Pomerantz Declaration.
	Appendix B	Provisional redaction of information pending resolution of dispute described in Paragraph 7 of Pomerantz Declaration.

F

CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that on October 7, 2014, I caused a copy of the **(1) RESTRICTED WRITTEN DIRECT STATEMENT OF SOUNDEXCHANGE, INC. and (2) PUBLIC WRITTEN DIRECT STATEMENT OF SOUNDEXCHANGE, INC.** to be served by electronic mail and overnight mail to the Participants as indicated below:

Participants

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Rose Leda Ehler

CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that on October 7, 2014, I caused a copy of the **PUBLIC WRITTEN DIRECT STATEMENT OF SOUNDEXCHANGE, INC.** to be served by electronic mail and overnight mail to the Participants as indicated below:

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for the Written Direct Statement of SoundExchange, Inc.
14-CRB-0001-WR (2016-2020)

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

TESTIMONY OF

DENNIS KOOKER

President, Global Digital Business and U.S. Sales,
Sony Music Entertainment

PUBLIC VERSION

Witness for SoundExchange, Inc.

TESTIMONY OF DENNIS KOOKER

BACKGROUND

My name is Dennis Kooker. I have been employed in the recorded music business for approximately 20 years. Since 2012, I have served as President, Global Digital Business and U.S. Sales, for Sony Music Entertainment ("Sony Music"), a wholly owned subsidiary of Sony Corporation, and currently the second largest record company in the United States. In this capacity, I am responsible for overseeing all aspects of the Global Digital Business Group and the U.S. Sales Group. The Global Digital Business Group handles business and partner development and strategy for the digital business around the world. The U.S. Sales Group oversees sales initiatives on behalf of each of Sony Music's various label groups in the United States. The areas within the organization that report to me include Business Development & Strategy, Partner Development, Digital Finance, Digital Business & Legal Affairs, U.S. Sales, and Sony Music's distribution service company, RED Distribution.

From 2007-2012, I held two different positions at Sony Music. First, I was Executive Vice President, Operations, for the Global Digital Business and U.S. Sales, and oversaw physical sales, aspects of marketing and finance for the division, new product development, and customer relationship management activities in relation to Sony Music's artist websites. I also developed and implemented key commercial strategies and policies for the physical and digital distribution of our repertoire. After that, I oversaw all aspects of the day-to-day operations of the Global Digital Business and U.S. Sales as Executive Vice President, Operations, and General Manager. During this entire period, the Digital Finance, Sales Reporting, research, and U.S. Supply Chain areas reported to me, and I had general oversight with respect to the artist website and direct-to-consumer sales groups.

From 2004 to 2007, I was Senior Vice President and Controller for Sony BMG Music Entertainment (Sony Music's corporate predecessor). Prior to that, I held a variety of positions with BMG, the music company owned by Bertelsmann AG.

I hold a Bachelor of Science in Business Administration from Shippensburg University and an MBA from St. Joseph's University.

DISCUSSION

I. Sony Music's Position in the Recorded Music Industry

Sony Music is a global recorded music company with a roster of current artists that includes both domestic and international superstars. Its record labels, including Arista Nashville, Columbia Nashville, Columbia Records, Epic Records, Kemosabe Records, Legacy Recordings, Masterworks, RCA Records, RCA Nashville, RCA Inspiration, Sony Classical, Sony Music Latin, and Syco Music, create and distribute music from every genre.

These record labels are home to a wide array of artists, including some of the most popular recording artists in the world. These include Adele, Aerosmith, Beyoncé, Kenny Chesney, Kelly Clarkson, Bob Dylan, Billy Joel, Alicia Keys, Ricky Martin, Yo-Yo Ma, Carlos Santana, Bruce Springsteen, Barbra Streisand, Justin Timberlake, Usher, and many others. Sony Music's vast catalog of recorded music—which dates back over one hundred years—comprises some of the most important recordings in history, including works from many of music's most legendary artists, such as Miles Davis, John Denver, Carole King, Johnny Cash, Frank Sinatra, Rosemary Clooney, Bing Crosby, Benny Goodman, Al Jolson, Janis Joplin, Louis Armstrong, Dolly Parton, Elvis Presley, Vladimir Horowitz, Glenn Gould, Stevie Ray Vaughn, Meatloaf, Glenn Miller, Whitney Houston, and Michael Jackson, to name a few.

Sony Music's year-to-date market share for CD albums in the U.S. is approximately 28.2% (including both owned and distributed repertoire), and its year-to-date U.S. digital market share for digital albums is approximately 26.5% (including both owned and distributed repertoire).

II. Creating, Distributing, and Marketing Recorded Music Is a Capital- and Labor-Intensive as Well as a High-Risk Business

Sony Music makes large capital investments and undertakes substantial risks to create, produce, market and distribute high quality, popular recorded music. Sony Music's investment activity starts with the discovery of talent, primarily through the legwork—literally—of members of our Artists and Repertoire ("A&R") departments. Among other things, A&R representatives go to nightclubs and music festivals throughout the country; spend countless hours listening to "demos"; and search for new artists and emerging trends on the internet. Out of the hundreds or even thousands of potential artists that our A&R departments scout, only a small handful of new artists get signed to recording contracts. In addition, Sony Music invests in third parties who find and develop talent under a range of different business arrangements, such as "label deals," joint ventures and distribution deals. This time-consuming and laborious "research and development" process involves the skills of an array of uniquely talented personnel who have a track record for finding the "next big thing."

Once an artist is signed, Sony Music spends considerable amounts of time and money identifying repertoire to be recorded, hiring producers and musicians, recording the music, honing the artist's interview and live performance skills, and working closely with the artist on the branding and imaging that the artist will use to launch their career.

Among the most significant talent-related expenses are recording costs and artist advances, which enable the artist to make the best recordings possible and subsidize the artist's

living expenses during the recording process. We advance millions of dollars each year for these purposes, including the costs of studios, equipment, background musicians and performers, sound engineers, producers, and all of the other creative talent required to make a top quality sound recording. Our total expenditures for investing in talent and recordings in our most recent fiscal year, ending in March 2014, were roughly [redacted]. (This figure reflects only our out-of-pocket expenses and does not include the salaries and other overhead costs that are required to locate and sign talent and to oversee the recording process, such as the A&R staff discussed above, which account for millions of dollars more.)

Of course, making a sound recording is only the beginning of the process of bringing the artist's work to a public audience. Once a recording is made, it has to be distributed and marketed. For physical products, there are significant manufacturing costs. For example, in the fiscal year ending March 2014, we invested over [redacted] in the manufacturing of physical products, including CDs.

We also spend substantial sums distributing both physical and digital product. Excluding overhead, Sony Music's costs of distributing physical products in the last fiscal year exceeded [redacted]. For the same period, we invested more than [redacted] to digitally distribute our content, including the costs of employees dedicated to the digital business. We also incur substantial royalty costs, including payments to songwriters and publishers in connection with our music distribution.

Our marketing and promotion costs are even higher than our manufacturing and distribution costs. Sony Music's team of marketing professionals provide world class marketing and promotion services for every Sony Music release. The marketing plan for any project will generally include a variety of components, like promotion, publicity, social media, live tour

support, video promotion, and brand sponsorship, as well as traditional media like print and TV advertising. In the most recent fiscal year alone, we invested over [redacted] to sell and market our recordings, including our out-of-pocket marketing expenses and our selling and marketing overhead. All told, we must invest hundreds of millions of dollars annually to connect our artists' visions to their fans.

The money that we invest in recorded music yields substantial dividends to numerous parties besides Sony Music. First, our investments inure to the benefit of individual artists. Once established, the power of an artist's brand of recorded music goes far beyond the sale or other immediate exploitation of that music. An artist's popularity typically translates into a lucrative career as a songwriter, a touring career, the potential for a career in other media (*e.g.*, film or TV), and the possibility of selling other products (everything from clothing lines to fragrance).

The artists we support and the music they create also drive the engines of many other industries, including webcasting and other digital services; satellite and terrestrial radio; live events and touring; various types of consumer electronics, online games and internet applications; merchandise sales; and music publishing, to name just a few. Each of these industries creates jobs, revenue and growth for numerous interested parties and investors. Of course, Sony Music's investments ultimately contribute to the important and unique culture of American music. Today, more than ever, music lovers expect and enjoy the constant flow of new creativity—be that from new recordings or from newly imagined or improved versions of older recordings.

All of this activity starts with the substantial capital that Sony Music and other record companies put at risk every year to find, develop, and promote new talent. As with other "R&D"

driven industries, the risks that we undertake are significant. Notwithstanding Sony Music's best efforts to control costs—particularly in this era of shrinking revenues—we still must spend considerable money to support new releases. The majority of those releases, however, do not return a profit. Most advances are eventually written off. In order for us to continue finding and developing the musical talent that the public desires, we must earn a fair return on the exploitation of our content.

III. The Recording Industry's Transformation from Physical to Digital Sales to the Rise in Music Access Services—and the Corresponding Challenges to Our Ability to Earn Returns on Investments and Make New Ones

As discussed, Sony Music's fundamental challenge is to earn a fair return on the vast sums that we must spend every year to create the music that the public consumes. We make that return by being compensated for the consumption of our content. The way that our content is consumed has undergone radical transformation over the last decade. The changes continue at a rapid pace. That transformation has wide-ranging consequences for our ability to continue to invest the millions of dollars that are required to operate our business. In this Section, I describe the nature of this transformation and the challenges that Sony Music and the entire recorded music industry face as a result.

In Section A, I describe in detail the changes in the way our content is disseminated and consumed—and how we are paid for its exploitation. In particular, music consumption is rapidly shifting from a model based on music ownership (whether physical or digital) to a model based on access to massive libraries of musical content. In a world of music access, the returns to Sony from licensing its content to online services are tied to the revenues that services generate. This means that the higher average revenue per user ("ARPU") that the service generates, the higher the returns to us. As I explain below, the highest ARPU is generated from paying subscribers of

directly licensed services. Our ability to continue to make the investments necessary to invest in new talent and new recorded music will depend on our direct licensees being able to convert free listeners to paid subscribers.

In Section B, I discuss the challenges that direct licensees face in converting free listeners to paid, high-ARPU subscribers because of head-to-head competition from statutory services, and in particular because those statutory services' functionality is rapidly converging with the functionality offered by our direct licensees.

In Section C, I discuss why statutory services do not promote, but instead substitute for, our direct licensees' high ARPU offerings.

A. The Transformation of the Recorded Music Industry

1. The Shift from Physical to Digital

Historically, Sony Music's revenues were principally derived from the sale and distribution of pre-manufactured physical products, including vinyl records, cassette tapes, and more recently, CDs and DVDs. Unlike music publishers, who have long enjoyed the revenues generated from their public performance right every time their songs get played on the radio or TV, the recorded music industry for most of its existence was almost entirely dependent on the revenues generated by the sale of these packaged goods.

Over the last decade, sales of our physical products have fallen precipitously year-over-year. This decline is the result of numerous factors, including the massive online piracy unleashed starting in 1999, advances in technology, and changing consumer preferences. Figures collected and reported by the RIAA show the dramatic decline in record industry revenues caused by the shift away from physical product. The retail value of music distributed

in the U.S. in 2013 was just under $7 billion. This was down almost 20% from $8.7 billion in 2008, and down an astonishing 52% from $14.5 billion in 1999.

Those figures can be broken out further to illustrate the downward decline in physical revenues. In 1999, U.S. manufacturers distributed CDs with a total retail value of $12.8 billion. By 2008, the retail value of CD shipments was down to $5.5 billion—a 57% drop from 1999. And revenue from physical product has only continued to decline. By 2013, the retail value of CD shipments was down to $2.1 billion—a drop of more than 60% from only five years earlier.

Consistent with the nationwide trends, Sony Music's revenue from physical distribution has fallen substantially. Sony Music's U.S. sales of physical product fell from [redacted] in the fiscal year ending March 2009 to [redacted] in the fiscal year ending March 2014.

While revenue from physical product has been shrinking, revenue from digital product has increased—though nowhere near levels sufficient to close the gap caused by plummeting physical sales. In 2013, which was a high-water mark for digital revenues for the recorded music industry, total digital revenues were $4.4 billion—well short of what would be needed to offset the $10 billion annual decline in physical sales that the industry has experienced since 1999.

As with the industry generally, while Sony Music's digital revenues have increased over the last decade, those increases have not been close to sufficient to close the gap from declining physical revenues. In the fiscal year ending March 2014, our total digital revenue was [redacted] (about [redacted] of Sony Music's total revenues). This was an increase from digital revenues five years earlier, when digital revenue for the fiscal year ending March 2009 was [redacted] (about [redacted] of Sony Music's total revenues). While this change represented a [redacted] increase in annual digital revenues by the end of the five-year period, the corresponding decline in annual physical sales was [redacted].

There are several additional observations that are important to make about the shift from physical to digital revenues in the music business generally, and at Sony Music in particular. First, the transition from physical to digital involves not only dramatic revenue reductions, but also substantial investments. There is a popular misconception that the shift from physical to digital distribution entails dramatic cost savings for a record company. In fact, we have to invest heavily in the infrastructure and personnel necessary to maintain a digital business. We have to pay for hardware and software—and continually upgrade the same—in order to digitize and store our content; to transmit it to our digital partners; and to ingest our partners' reporting activity, so that we in turn may account to our artists and other interested parties. And, of course, we have to employ personnel to make these processes run and manage all aspects of a digital business. In our last fiscal year, we expensed more than [redacted] in equipment, software and personnel directly related to digital distribution. And, of course, we invest hundreds of millions of dollars more each year in overhead costs that are necessary to run a digital business.

Second, digital revenues will continue to constitute even higher proportions of our revenues as compared to physical in future years. Simply stated, digital revenues—including revenues from streaming services—are and will remain the primary revenues we will depend on to continue making the substantial investments required to operate a recorded music company.

Third, the growth in digital revenue has been nowhere near sufficient to make up for the corresponding decline in physical revenues. The numbers above testify to the dramatic gap in revenues created by the transformation from physical to digital distribution. The consequences have been severe. There has been dramatic consolidation and contraction in the record business. In 1998, there were six major record companies in the U.S. (BMG, EMI, MCA, PolyGram, Sony Music, and Warner Music Group). Today, there are only three (Sony Music, Universal Music

Group and Warner Music Group), and the most recent consolidation (Universal Music Group's acquisition of EMI's recorded music business) took place only within the last two years. The substantial reduction in revenues and consequent industry contraction has led to the loss of thousands of jobs at Sony Music and across the entire music industry. Indeed, the number of Sony Music employees in the U.S. at the end of 2013 is approximately [redacted] of the number employed at Sony Music at the end of 2005.

At the same time that our revenues have been shrinking, music consumption has been expanding dramatically. More people are listening to more music now than ever before. But the people who invest in finding talent and bringing new musical works to market are not realizing the benefits of this increased consumption. The challenge, to which I return below, is to remedy this extreme imbalance in the digital world.

2. The Shift from Ownership to Access Models

We currently are in the midst of another major transformation of music distribution—from a digital model based on "ownership" of music to a new model of "access" to digital music. Most of Sony Music's digital revenue in the U.S. over the last decade came from sales of permanent digital downloads (through iTunes, Amazon or other similar online and over-the-air download services), which consumers purchase and store on their digital devices. The last several years, however, have witnessed an explosion in online streaming services. Streaming services represent the second largest component of the digital music business, enabling users to access millions of songs from their personal computers or mobile devices without actually buying the music.

According to a recent MIDiA consumer research survey, [redacted] of people in the United States report having listened to music streamed freely online.[1] For those online services that report at least some of their user information, the growth numbers are staggering. Pandora, which operates under a statutory license at pureplay settlement rates, reported 76.2 million active users by year-end 2013—an increase of more than 16% from 65.6 million active users just one year earlier. Pandora reported that its total listener hours grew to 15.31 billion for the 11 months ended December 31, 2013, compared to 12.56 billion listener hours in 2012—an increase of nearly 22%.

A number of factors have accounted for the increasing popularity of streaming services, including the widespread availability of broadband internet connections, the huge expansion of content-delivery from "cloud" storage systems, and the massive growth in the deployment of "smartphones" and other handheld mobile devices that enable internet access from almost any location. Consumers who once bought permanent downloads to listen to remotely on iPods and other portable devices now have virtually unlimited access to music streams through smartphones and associated "apps." Services generally distribute their apps for free, and they have become extremely popular with consumers. For example, Pandora's free mobile app is the fifth most popular app on smartphones, accessed by around 69 million unique visitors.[2]

As technology has made online streaming more widely available, numerous players pursuing diverse business models have flocked to the market for streaming services. These include companies whose primary consumer offering is online streaming, such as Pandora or

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[1] MIDiA Consumer Research Survey June 2014.

[2] http://www.radiosurvivor.com/2014/08/24/internet-dj-week-youtube-becomes-youpay/. (reporting Comscore rankings of smartphone apps).

Spotify. The market also includes companies that offer both streaming and download purchases, such as Apple (which last year launched iTunes Radio). Some companies bundle online streaming with other consumer products, such as Amazon Prime Music (which is bundled with the Amazon Prime subscription service), or with wireless access, such as Cricket and Metro PCS/Rhapsody (which bundle music access offerings with mobile data plans). Other companies, such as Clear Channel (recently renamed "iHeartMedia"), offer a combination of online streaming services, some of which simulcast internet transmissions of the broadcasts from their terrestrial radio stations, and others that provide stations the user can customize based on personal preferences. In a world in which access to streamed content is increasingly dominant, the wide range of streaming services (including statutory licensees) are competing for the potential of consumer dollars that were once spent at record stores and, decreasingly, at online stores for permanent downloads.

Sony Music's revenues from streaming services reflect the shift from an ownership model to the access model. Our revenue from various streaming services has increased from around [redacted] in the fiscal year ending March 2009, to approximately [redacted] in the fiscal year ending March 2014. However, during the same five year period, Sony Music's revenues from sales of permanent downloads have flattened, and most recently have started to drop. Importantly, for the five months ending August 2014, Sony Music's revenues from download sales have decreased by [redacted] from the corresponding five-month period in 2013. Based on market trends, we expect the decline in permanent download sales to be permanent. The decline in permanent download revenues when compared to the increase in streaming revenue illustrates the challenge of simply maintaining a stable ARPU in the face of increased consumption through the access model.

Statistics from across the record industry show that Sony Music's experience with streaming and download revenues is no aberration. According to RIAA data, the proportion of total music industry revenue from all forms of digital streaming services grew from 4% in 2008 to 21% in 2013. Revenue from streaming services to record companies during the first half of 2014 grew by 28% over the preceding year—to $859 million from $673 million during the first six months of 2013. Revenues from the sales of permanent downloads, in contrast, decreased 12% across the same time period—from $1.486 billion at midyear 2013 to $1.305 billion at midyear 2014.

Sony Music anticipates that the movement away from ownership and toward access models will further accelerate over the course of the next statutory rate term. A significant amount of this growth in access models has been and will continue to be fueled by the rapid proliferation of streaming services operating under the statutory license created by Section 114 of the Copyright Act. Such statutory services pay significantly lower rates for our content than our direct licensees. Unsurprisingly, numerous services operating under the statutory license have entered the market seeking to take advantage of these lower rates. The result is a huge expansion of services that make use of our content and, as a consequence, a downward pull on the rates that we can charge our direct licensees. For all of these reasons, the economics of the statutory license for streaming services are of critical importance to us.

3. A Healthy Streaming Sector Relies on the Generation of Higher ARPU

Our content is the core of a streaming services' consumer offering. Without a wide array of recorded music, music streaming services have little to offer their users. If we are to continue to achieve returns on our investments and make new investments in the artists and music of

tomorrow, it is imperative that we receive returns from the services' use of our music that is proportional to the value that we contribute to those services.

We have found that streaming services cannot generate revenues sufficient to compensate us for the value of our music unless those services increase the revenues—specifically, the ARPU—they generate from the consumption of our music. Streaming services are generally unable to significantly increase their ARPU through advertising alone. While there has been some growth in recent years in advertising on streaming services, neither the amounts that advertisers pay nor the average time that services run advertisements are on par with the corresponding dollar amounts and number of ads per hour on terrestrial radio. For example, Pandora's free service runs an average of only five advertisements per hour, lasting a total of between 2.5 and 3 minutes. On its iheart.com site, iHeartMedia (formerly Clear Channel) promotes ad-free, uninterrupted listening on its custom stations. Terrestrial radio, by comparison, runs an average of 17.5 minutes of advertisements per hour.

The limited revenue from advertising on streaming services' free-listening tiers translates into ARPU that is significantly lower than ARPU from directly licensed services' subscription tiers. For example, Pandora reported advertising revenues of $489.3 million for 2013. Spread across Pandora's 76.2 million users at year-end 2013, this yields ARPU from advertising of just $6.42 annually. In contrast, many directly licensed paid subscription services generate annual ARPU of $119.88—many multiples greater than Pandora's ARPU. (Pandora reported subscription revenues for 2013 of $110.9 million. Pandora's subscription revenues do not yield market rate returns to artists and content owners. Even combining Pandora's advertising and subscription revenues yields total annual ARPU of just $7.88—which still is many multiples below the ARPU of many directly licensed paid subscription services.)

The lesson from all this is clear: our ability to continue to risk our capital and invest in new talent depends on healthy growth in paid subscriptions to our direct licensees.

B. Interactive Services Compete Head-to-Head With Statutory Services, and the Functionality the Different Services Offer Is Rapidly Converging

Unfortunately, the ability of our directly licensed partners to increase the numbers of paying subscribers is significantly hamstrung by competition from statutory services. The reality is that consumers only have a finite amount of time to consume music in a day. Sony Music has licensed its catalog to all of the major interactive streaming services operating today—Spotify, Rhapsody, Rdio, Google Play and Beats, among others. We work hard to craft deals with these partners that provide a reasonable return to Sony Music for the decades of risk and investment that went into creating the rich Sony Music catalog. Yet, all of these services compete head-to-head for listener hours with services that operate under the statutory license.

As noted, statutory licensees pay for their content at compulsory rates, and as a consequence exert downward pressure on privately negotiated rates. One of the original justifications for allowing statutory services to pay these lower rates was that the offering under the statutory license would provide a user experience similar to terrestrial radio. Statutory services could offer channels of particular musical genres, but the programming would be selected by the service. If listeners wanted to select their programming, they would have to pay for it through directly licensed services.

That fundamental distinction—between statutory services mirroring terrestrial radio and directly licensed services enabling customized music access—is rapidly disappearing. Statutory services now provide highly customized offerings to consumers. Statutory services employ sophisticated algorithms, user-interface controls, and other computer technology that allow users to communicate their preferences to the service, and the service to customize and curate

programming tailored to the individual user. Examples include interfaces that enable a user to communicate to the service whether they like or dislike content the service is streaming—"thumbs up" or "thumbs down"—and for the service to use that feedback to select the programming it will stream to that user. Through this two-way communication, the user can significantly increase or decrease (or, with enough dislikes, eliminate completely) the likelihood of hearing more music by the same artists. The result is that statutory services can and do progressively refine the individualized programs streamed to their users, thus bringing the experience of listening on statutory services ever-closer to the experience of "on-demand" listening.

Customized radio is just one way in which we have seen convergence between the experience of users of statutorily and directly licensed services. There are others. Both types of services increasingly offer other forms of functionality that are similar along a number of dimensions. For example, statutory services now stream to mobile devices, which used to be a significant incentive that direct licensees could use to migrate free listeners to higher-ARPU paid subscribers. Both types of services also offer users "curated" playlists that the services attribute to popular music "tastemakers"; integration with social media (*e.g.*, Facebook) that enables sharing of playlists with online friends; "recommendations," whereby the service suggests new songs or stations for the user to listen to; and a variety of other common functionality.

The ability of statutory services to offer customized radio and other comparable functionality provides those services considerable competitive advantages against direct licensees trying to convert listeners to higher-ARPU subscription tiers. In the first place, statutory licensees pay only the statutory royalties established for more traditional, non-interactive, non-customized streaming, whereas directly licensed services typically pay higher

rates. Statutory licensees enjoy other relative cost advantages in comparison to directly licensed services, including the fact that statutory licensees do not have to comply with reporting, security, and other requirements that our agreements require of our directly licensed partners. (I discuss these requirements in further detail in Section IV, below.) On the revenue side, statutory licensees have no legal obligation to try to transition their "free" listeners to paid tiers.

The result of all this is a further downward pull on directly licensed services' ability to generate higher ARPU for themselves, and to return higher revenues to content owners. Direct licensees find themselves competing for listeners with closely comparable services that pay substantially reduced rates and that make little or no effort to convert free listeners to paying subscribers. The overall consumer offering on a directly licensed service often will have enhanced functionality (*e.g.*, "on demand" access to particular tracks) and additional listening flexibility not found on a statutory service's offering. But it is difficult for direct licensees to convince users that the differences are worth paying for.

Users also face costs other than monetary charges when contemplating switching from free statutory services to paid subscription offerings. The inputs that users of statutory services provide to fine tune their customized offerings, their channels, and other recorded preferences are not transportable to directly licensed subscription services. The prospect to users of losing their own investments in the customized offering provides another disincentive to moving from a statutory to a directly licensed subscription service. Simply put, it is hard to compete with free—and all the more so where free has comparable functionality and users perceive costs to switching.

In sum, statutory and direct licensees have never been closer in terms of the functionality they offer to consumers. I expect that convergence will continue through the coming rate period.

I also expect that this convergence will provide significant disincentives for consumers to migrate from free to paid services, frustrating our efforts to close the gap in revenue caused by declining sales.

C. The Promotional Benefits from Statutory Streaming Services Do Not Come Close to Offsetting their Substitutional Effect

Statutory licensees frequently try to justify low compulsory rates on the ground that their free offerings promote other sources of record company revenue, such as sales of CDs and permanent downloads. Based on Sony Music's experience and my observations of the broader industry, I believe this proposition is simply untenable in light of market developments.

In the recorded music business, promotion means taking an action with some limited amount of content to incentivize broader consumer awareness and sales. Traditionally, this has meant providing access to some music for free (or at a significantly reduced price) in order to interest consumers in the same or similar products and to incentivize consumers to spend money on such products. An example of this would be a time- or quantity-limited distribution of free singles of an individual track in order to generate consumer interest in buying the album containing the single, other tracks or albums from the same artist, or other parts of our repertoire.

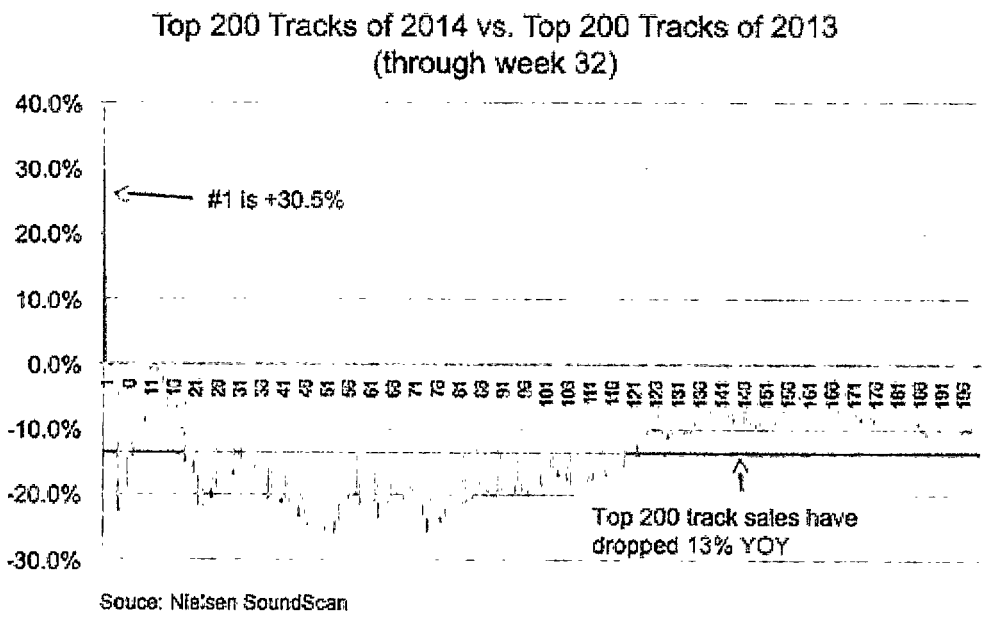
The concept of promotion is a misnomer when applied to streaming through statutory services. In a world increasingly moving to music access rather than music ownership, obtaining access to free streaming does not promote sales, but rather is an end in itself. Streaming is not promoting sales of product. It is the product. Based on Pandora's most recently announced user metrics (from May 2014), its users spent an *average* of 22.5 hours per month listening to the service (1.73 billion listening hours divided by 77 million monthly active listeners). That is a remarkably high level of monthly consumption for a service often touted as simply engaging casual listeners. Moreover, if someone is listening to 22.5 hours per month on Pandora—and

that is just the average—it decreases the likelihood they will have the additional time, interest or inclination to consider paying for music on higher-ARPU directly licensed subscription services.

Statutory services are unlike true promotional activities in many other ways. Statutory services do not make a relatively small number of our works available for free listening for limited times. Statutory services instead use enormous portions of our most popular repertoire and make those works available for free listening in perpetuity. And, as discussed above, statutory services increasingly customize and curate content for individual listeners, such that the individual user's listening experience is much closer to a station designed for one. This, in turn, provides significant *dis*incentives for users to pay for music access. If a consumer is increasingly confident that the next song they hear or the next playlist they select will be closely in synch with their musical preferences, it becomes increasingly difficult to persuade that consumer that they should buy tracks or albums.

We already are witnessing the substitutional effect that streaming services are having on download sales. As reported by *Billboard* (and illustrated in the following chart), with just one exception, every song in Billboard's "Top 200" list of download sales in 2014 through week 32 had sold *fewer* downloads than songs in the corresponding place on the same chart in 2013[3]:

[3] http://www.billboard.com/biz/articles/news/digital-and-mobile/6221778/pharrells-happy-is-a-rare-bright-spot-in-track-sales.



The one exception to this downward trend was the song "Happy," by Pharrell Williams, released on Sony Music's Columbia Records label. But for that exception, releases across our company, and the industry as a whole, have sold fewer copies in 2014 than in 2013. As discussed, our fiscal-year-to-date sales through iTunes and other online retailers of permanent downloads have fallen off from the same period in the preceding fiscal year, and we expect that decline to be permanent. We have not seen any evidence that statutory services have a significant promotional effect on the sale of physical product. Plainly, statutory services are not making a significant promotional contribution to sales of recorded music. Access is supplanting sales, and statutory services are providing access—which is the end product. Any promotional effect statutory services might have is insubstantial compared to the substitutional effect that streaming is having on sales of recorded music.

Nor have we seen evidence that statutory services are significantly promoting users to upgrade to higher-ARPU subscriptions through directly licensed services. Based on my observations of the market, I believe that statutory services have quite the opposite effect, and in

general are making it less likely that their users will pay for higher-ARPU subscription offerings through directly licensed services.

IV. How Sony Music Approaches Deals with Streaming Services

In this Section, I describe briefly some of the key components of our deals with directly licensed services. These components include both monetary and non-monetary consideration we receive for the exploitation of our repertoire. None of these valuable deal components are included in the statutory license.

One of the most important components of our direct agreements is that they generally include a payment structure based on [redacted]. This structure ensures that, regardless of the service's business model, Sony Music is fairly compensated for the fact that it and its artists provide the backbone—the music—that is the foundation for the service. The general deal structure further ensures that, if the service is successful and has significant revenues driven by the availability of Sony Music content, Sony Music will share in that success.

For services that include a free-listening tier, Sony Music strives to obtain deal terms intended [redacted], which helps to maximize the service's ARPU, and thus overall revenue to Sony Music. For example, Sony Music tries to [redacted]. It is generally recognized that increasing the ad-load of any service serves as an effective tool to drive consumers to convert from free to paid services.

Sony Music also requires licensees to meet rigorous security provisions, specifies the audio quality of streams offered by a service, and [redacted]. Sony Music also negotiates detailed reporting requirements, along with technical and financial auditing rights. In addition, Sony Music obtains access to various types of data, which we are able to use to understand consumer interest and to tailor our product offerings to stay current with consumer interests.

Where necessary, Sony Music negotiates holdback rights that restrict our direct licensees from streaming tracks based on restrictions in our artist agreements or for commercial purposes to drive consumer engagement. For example, Sony Music negotiates holdback rights so that it can create exclusive windows for certain content on specific platforms, enabling us to derive greater value, including by the way of lucrative sponsorship opportunities and promotional commitments. The scarcity created by these exclusive promotions proves quite useful in driving users to the services concerned. If, however, we have publicly distributed phonorecords containing the works, then the statutory license undermines our ability to create such scarcity on streaming platforms, since statutory licensees are able to start streaming works following such public distribution.

In addition, Sony Music generally negotiates short term agreements with digital services—from one to three years, depending on Sony Music's experience with the licensee. Sony Music limits the duration of its direct licenses so it is not locked into an unfavorable deal in a still-evolving digital environment. To the extent Sony Music enters into longer-term deals, Sony Music generally requires significant payments to protect it if the service becomes very successful, as well as some ability to terminate in the event the service does not perform as

hoped. The generally short term of our marketplace agreements allows us to continually reassess the viability of a given service and analyze whether any rates need to be adjusted. Five years is an eternity in the digital marketplace. The five-year term of the statutory license means that there is no opportunity to correct for any undervaluation until the next rate-setting proceeding.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: October 6, 2014

Dennis Kooker

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re **DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)**	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

TESTIMONY OF

RON WILCOX

Executive Counsel, Business Affairs, Strategic and Digital Initiatives
Warner Music Group

PUBLIC VERSION

Witness for SoundExchange, Inc.

TESTIMONY OF RON WILCOX

BACKGROUND

My name is Ron Wilcox. I am Executive Counsel, Business Affairs, Strategic and Digital Initiatives for Warner Music Group ("WMG"). In that position, I lead the business affairs efforts for WMG's major strategic and digital initiatives, and I work closely with WMG's digital legal affairs lawyers and WMG's Digital Strategy and Business Development department. Recently, I added oversight of WMG's digital legal affairs team to my responsibilities. I am one of the WMG attorneys primarily responsible for developing WMG's relationships and negotiating agreements with digital music services, including agreements that authorize the transmission of WMG's labels' repertoire through streaming services. I joined WMG in the spring of 2009.

I have worked in the music business for more than 30 years. Before joining WMG, I worked as an independent consultant from 2008 through early 2009. During this time, I was retained by Sony Music Entertainment ("Sony") (my immediate past employer) to negotiate, among other matters, a complex digital agreement for a bundled music-wireless service, Nokia's "Comes With Music." I also was retained by digital services, including digital music services such as Songza, and by recording artists, record companies and management companies to advise them on various transactions, including recording and other agreements. Before that, I worked in a variety of positions with Sony, ultimately serving as Executive Vice President and Chief Business and Legal Affairs Officer of Sony BMG Music Entertainment ("Sony BMG"). Sony BMG was a joint venture that combined the recorded music assets of Sony Corporation of America and Bertelsmann AG. In that position, I oversaw Sony BMG's business and legal affairs activities, including the negotiation of deals with digital music services and the

development of Sony BMG's policies concerning the dissemination of its content through online service providers. Prior to the formation of the Sony BMG, I was Executive Vice President, Business Affairs and New Technology at Sony. Between 1990 and 2000, I was Senior Vice President, Business Affairs & Administration at Sony. From 1983 to 1990, I worked in Business Affairs for Sony's predecessor, CBS Records, and prior to that, I was an attorney for CBS Inc.

I graduated from the College of Wooster in 1975 and the University of Michigan Law School in 1978.

DISCUSSION

I. Warner Music Group's Position in the Recorded Music Industry

WMG includes a collection of some of the best-known record labels in the music industry, including Atlantic, Bad Boy, Elektra, Lava, Maverick, Nonesuch, Reprise, Rhino, Sire, Warner Bros. and Word. These labels feature a comprehensive roster of recording artists and a large catalog that includes some of the world's most popular sound recordings by some of the most iconic and celebrated recording artists of today and in recorded music history. WMG repertoire includes sound recordings by, to name just a few, Prince, Linkin Park, Bruno Mars, the Eagles, James Taylor, Led Zeppelin and Phil Collins.

In addition, WMG operates Alternative Distribution Alliance (ADA), which for many years has been a leading distributor for independent record labels. WMG's Warner Music International, a leading company in national and international recorded music repertoire, operates through numerous international affiliates and licensees in more than 50 countries. WMG also includes Warner/Chappell Music, one of the world's leading music publishers, with a catalog of more than a million musical compositions.

WMG was publicly traded on the New York Stock Exchange prior to its acquisition in July 2011 by an affiliate of Access Industries, Inc. WMG is now privately held.

II. WMG's Approach to the Digital Distribution of Music

WMG has long been an industry leader in the digital marketplace. WMG's innovative tradition traces all the way back to its origin, in 1929, when the Warner Bros. movie studio first entered the music business. WMG has always striven to find better ways of connecting artists and fans by embracing the latest delivery technologies and the most innovative product, sales and distribution strategies. Today, WMG is at the forefront of the record industry's transition from physical distribution to digital distribution. WMG manages a variety of music-based content that is marketed, promoted and distributed over a wide array of online and mobile platforms.

WMG believes that digital distribution is the key to new growth in the record industry. WMG has incorporated digital distribution as a central part of its business strategy. Sales of CDs and other physical media have continued to decline in recent years, as they have for more than a decade. Revenues from digital distribution—including from sales of permanent downloads through iTunes and other online retailers and from online streaming services—have become a critical component of WMG's business. In WMG's last reported financial quarter (the quarter ending June 30, 2014), WMG's digital revenues had grown to 58.9% of its total U.S. recorded music revenues, up significantly from 37.0% of its total U.S. recorded music revenues for the same financial quarter in 2009. WMG's digital revenues will continue to comprise a greater and greater share of its total revenues in the coming years. It is imperative, therefore, that WMG increase its digital revenues in order to compensate artists appropriately, discover new musical talent, produce the highest quality recordings, and market and promote artists to the widest possible public audience.

Over the past decade, technological developments have enabled music lovers to enjoy music in many new ways and have provided more immediate access to music than ever before.

The rise of digital services has fundamentally altered WMG's view of how to generate revenues from distributing its sound recordings. Whereas in the past WMG was primarily concerned about the sales of physical products, such as CDs, WMG now views each potential distribution model in terms of its impact on all other distribution channels. The wide range of digital services appeal to different consumers, but all have the potential to substitute for one another. A key component of WMG's digital strategy therefore is to negotiate marketplace agreements so as to maximize overall return to the company. Each business that WMG authorizes to exploit its content needs to provide a distinct revenue stream that either contributes meaningfully to WMG's bottom line, or that has the realistic potential to develop a business model that, over time, is likely to make such a contribution. It is WMG's goal to execute deals only at prices that are designed to generate sustainable revenues over the long term.

WMG's overarching strategy for digital agreements is to find and exploit all potential avenues for monetizing the experience of listening to its recorded music. WMG is not interested in allowing its sound recordings to be used for free in the name of "promotion" alone. The fact is that, in 2014, the ubiquity and high quality of digital distribution have fundamentally transformed the concept of "substitution." Prospective consumers can obtain free access through streaming services—including many that operate pursuant to the statutory license—to a wide range of music whose selection is customized to her or his musical tastes, or that is contained on playlists curated by friends or popular tastemakers. The idea that such unlimited access—without some additional element to incentivize music purchasing—promotes sales is fanciful. For WMG, authorizing the use of its music on services that will be "free to the listener" must be a means to an end of trying to stimulate listeners to pay for the core product they consume. Such payment may come, for example, in the form of subscription payments that allow for streaming

without advertisements, that allow listeners to skip through songs without limitation and/or that enable streaming on mobile devices.

III. Overview of WMG's Marketplace Agreements with Digital Distribution Services

WMG has entered into numerous agreements with various digital distribution services. Its digital group now negotiates upwards of 190 deals each year—including new agreements, amendments to existing agreements, extensions, and renewals—with a wide variety of digital service providers. WMG's agreements evidence the terms to which willing buyers and willing sellers agree in the marketplace. Many of WMG's agreements are with sophisticated parties operating a number of different music services. Through free market negotiations, WMG is able to obtain significantly higher rates and/or significantly more valuable overall deal terms than WMG receives through the statutory license. It is important to note, however, that the existence of the statutory license and compulsory statutory rates affects the marketplace rates that directly licensed services are willing to pay. Because statutory services compete with directly licensed services, the statutory rates act as a constraint on the rates WMG can negotiate with those directly licensed services.

In Section A below, I provide a very brief summary of the relevant general terms that WMG works to obtain in agreements with streaming services. In Section B, I discuss some of the unique features of WMG's 2013 agreement with iHeart Media, Inc. formerly known as Clear Channel Communications, Inc.

A. WMG's General Framework for Agreements with Streaming Services

As noted, WMG has negotiated numerous deals for the digital exploitation of WMG's extensive catalog of copyrighted sound recordings.

In marketplace deals, there are a few significant elements that are of particular value to WMG and are important components of WMG's negotiating strategy. WMG is not able to secure any of these elements under the statutory license and existing statutory rate structure:

[redacted] The single most important aspect of WMG's negotiated agreements is that they almost all feature a payment structure based on [redacted]. This [redacted] approach ensures that WMG is paid revenues that reflect the value that its sound recordings provide to the applicable service. Without the music, these services—whether ad-supported, free-to-the-listener, or paid subscription—simply would not exist. This [redacted] structure ensures that if the service is tremendously successful and has significant revenues driven by its ability to deliver WMG content, WMG shares in that success. It also ensures that if the service is not successful, the value of WMG content is still protected.

[redacted] WMG's agreements with streaming services generally require [redacted]. WMG seeks these commitments to ensure that its digital partners will invest their time and resources to make their service offerings succeed. Such financial commitments also comprise a critical component of the consideration WMG requires for the use of its music.

Access to data. WMG's agreements generally require its streaming service partners to provide it with data and/or analytics about music consumption and user preferences. Such data help WMG refine and improve its A&R, production and marketing efforts.

Security provisions. WMG requires directly licensed streaming services to satisfy specific and detailed security requirements to protect the security of WMG content.

Holdback rights. WMG negotiates the right to withhold content for a number of reasons, including artist relations and limitations imposed by agreement, and also negotiates for holdback rights that allow WMG to provide certain content exclusively to other services or on other platforms, and thereby maximizing the value to WMG.

Reporting requirements and audit rights. WMG requires extensive reporting information from digital partners so WMG can report to publishers and artists accurately. WMG also secures meaningful rights to conduct audits to ensure that partners are meeting their technological and monetary commitments.

Short-term licenses. Given the evolving nature of the digital space in general, and the streaming space in particular, WMG generally does not enter into direct licenses with terms longer than two or, in rare cases, three years. The relatively short terms of these agreements allow WMG the opportunity to negotiate extensions, amendments, or new agreements that reflect marketplace developments.

B. WMG's Agreement with Clear Channel

One of WMG's recently concluded streaming agreements has been the focus of considerable media commentary and discussion, and I discuss some of its key terms here. In October of 2013, WMG entered into a trial agreement with iHeart Media, Inc. formerly known as Clear Channel Communications, Inc. relating to Clear Channel's internet simulcast and non-

simulcast transmissions. I will use the name Clear Channel in this testimony, since that is how the company is still commonly referred to.

Clear Channel is uniquely positioned as a streaming service. Clear Channel has an established record as one of the premiere nationwide media companies providing terrestrial broadcasts, internet simulcast of those broadcasts, and non-simulcast webcasts, as well as concert promotions and music video services. Clear Channel controls a massive share of the terrestrial broadcast market. It owns or operates more than 800 radio channels in more than 150 markets nationwide. It streams internet simulcasts from a large number of its channels. WMG has enjoyed a close, positive relationship with Clear Channel for many years.

Prior to the October 2013 agreement, Clear Channel paid SoundExchange for internet simulcasts and non-interactive streams of WMG music at per-play rates established by the NAB settlement negotiated pursuant to the Webcaster Settlement Act. Over a long period extending through 2012 and 2013, Clear Channel and WMG negotiated an agreement for WMG to directly license Clear Channel's internet simulcast and non-simulcast streams of WMG music. The resulting agreement between WMG and Clear Channel strikes a compromise that, from WMG's perspective, provided sufficient overall consideration to make a trial agreement attractive. (The agreement—which is Exhibit 1 hereto—is entitled a "Trial and Experimental Internet Simulcast and Webcasting Agreement.") WMG and Clear Channel entered into an Amendment No. 1 to that agreement as of March 31, 2014 (Exhibit 2 hereto). Except as otherwise noted, the matters I discuss here relate to the October 2013 agreement.

WMG entered into the Clear Channel agreement because it perceived significant value in various contractual commitments—a number of which I describe below—that WMG believed Clear Channel would not be able to replicate in deals with other sound recording owners. WMG

thus believed the agreement provided it with very significant and unique economic advantages because WMG was the first major recorded music company to conclude a direct license with Clear Channel. The agreement also has provisions that ensure WMG will not be disadvantaged by being the first, or potentially the only, major recorded music label to have a direct deal with Clear Channel for internet simulcast and non-simulcast performances. The agreement has an initial term of three years, with a separate provision delineating WMG's right to extend the agreement for a three-year renewal term under certain circumstances.

Several features of WMG's agreement with Clear Channel deserve special mention and discussion here.

[redacted] There is no right under federal copyright law for sound recordings publicly performed over terrestrial radio. The amount of the [redacted]—is substantial. [redacted]

[redacted] ***for non-interactive webcasts***. Clear Channel has an active and growing service called "iHeart Radio," which provides, among other things, "user influenced" or "customized" webcasting, *i.e.*, streams of music programming to listeners that are influenced by and tailored to individual listener preferences. By definition, these streaming transmissions are not simulcast with terrestrial radio transmissions. For these transmissions, Clear Channel pays [redacted]

[redacted] This is an important concept that I return to below. [redacted] Clear Channel is contractually obligated to pay WMG [redacted]. This is a particularly valuable right for WMG. WMG's share of usage on any particular digital platform generally ranges between 15% and 20%, depending on the particular usage being measured (*e.g.*, individual track downloads or track-equivalent albums). If Clear Channel were to stream WMG's music roughly in proportion to WMG's general market share, WMG would expect its tracks to comprise around 15-20% of Clear Channel plays. [redacted] As a result, if Clear Channel [redacted]. In order to [redacted] The agreement also guarantees that WMG's royalties for the initial three-year term will be at least [redacted].

[redacted] Clear Channel also guarantees that, [redacted]. The [redacted] is defined by formula in the

agreement. The provision operates to ensure that [redacted]

Additional advertising consideration. The agreement also provides WMG with valuable consideration in the form of [redacted]. Among other commitments, Clear Channel must provide [redacted]. In particular, Clear Channel is obligated to provide WMG with [redacted]

The agreement further requires Clear Channel to provide, in addition to [redacted], [redacted] per agreement year. [redacted]

These and other advertising commitments and guarantees provide significant marketing value to WMG and its artists. Clear Channel's commitments also save WMG the expense of

comparable advertising. These commitments thus provide WMG substantial additional consideration as part of the overall deal.

Payments for [redacted]. Clear Channel also pays WMG for streams of [redacted]. This is another piece of valuable consideration to WMG in the entire deal.

In sum, WMG agreed to enter into the Clear Channel agreement because it believed the deal provided a unique opportunity for WMG to obtain far greater consideration for the use of WMG content than WMG would obtain if Clear Channel used that content pursuant to the statutory license. At the same time, WMG ensured through the [redacted]

IV. General Principles Regarding Defining "Revenue"

As discussed above, many of WMG's agreements with streaming services use a [redacted] In these agreements, the definition of "revenue" is an important issue. For WMG, it is critical that the agreement define "revenue" with sufficient breadth to encompass all income that the streaming service generates as the result of exploiting WMG's repertoire. To implement this concept, the agreements generally take care in delineating several components of the "revenue" definition.

First, the agreements generally define "revenue" [redacted]

[redacted]

Second, the agreements generally provide that [redacted]

Third, [redacted]

Whether this deduction is permitted and the terms of any such deduction depend on the specific circumstances of the agreement being negotiated as well as the service's business model.

If a directly licensed streaming service has income streams attributable to a combination of WMG's music and some other product or service, [redacted]

[redacted] For example, the service may offer consumers a bundle of items, such as access to music combined with a wireless phone plan. Or, the service may receive advertising income for ads that appear in connection with music offerings as well as other offerings. In these circumstances, [redacted]

V. Fees for Ephemeral Rights

In agreements with streaming services, WMG does not separately negotiate royalty rates for the performance of sound recordings and the making of ephemeral copies of sound recordings—*i.e.*, server copies. Rather, because licenses for both activities are required for the operation of a digital service, WMG negotiates a single bundled royalty rate that includes both rights as part of the license. In my experience, directly licensed services have not generally negotiated with WMG to obtain any specific allocation of royalties between the two license grants. This is most likely because directly licensed streaming services are not affected in any way by a specific allocation between the two rights, so long as they receive the full bundle of rights necessary to operate their service.

VI. Audit Rights

As noted, WMG's agreements with streaming services generally provide WMG with important rights to audit a service's compliance with its contractual commitments, including

payment and other obligations. While WMG has found that its partners generally aim to be diligent and accurate in their reporting, there are a number of factors that can cause a partner to fall short, including inadvertence, technical error, or the partner reads the agreement's requirements differently than WMG does.

WMG's agreements generally do not require that a certified public accountant ("CPA") perform royalty audits with its digital partners. Auditors who conduct royalty audits of digital services generally do not draw on the set of skills required to pass the CPA exam. Rather, royalty auditors must be able to understand the technical systems that WMG's partners use, to interpret data those systems maintain and generate, and the like. For example, a royalty auditor may have to examine a streaming service's server logs and content databases to determine the accuracy of the service's statement of performances and royalty payments. This could require understanding how the service's systems record digital performances, how those records are retained, and how those records are used to generate royalty statements. In addition, royalty auditors must be familiar with some of the unique conventions and jargon in the music industry as well as the royalty terms applicable to each service provider. For instance, auditors need to understand how to calculate a pro-rata share from a label pool, how performances are defined in the relevant contracts, and how to account for non-royalty-bearing plays.

Because royalty audits require extensive technical and industry-specific expertise, in WMG's experience a CPA certification is not generally a requirement for conducting such audits. To my knowledge, some of the most experienced and knowledgeable royalty auditors in the music industry are not CPAs.

VII. Role of the Collective for Statutory Licensing

WMG strongly believes that in the interest of efficiency for both the services involved in this proceeding and those who receive revenues from the statutory license, there should be one unified licensing collective, and that SoundExchange should be that collective.

SoundExchange is a nonprofit organization governed by an equally weighted coalition of artists (and representatives of artist organizations) and representatives of recorded music organizations. It takes a significant amount of time and effort for the interested constituencies to oversee and provide support (*e.g.*, Board and Board committee service) to SoundExchange. It would be very difficult for all interested constituents to provide comparable services in connection with more than one licensing collective.

SoundExchange has been repeatedly designated as the collective for statutory royalties and has done a commendable job in this role. It collects and distributes royalties from and to countless parties and persistently seeks out artists and record labels that may not be aware of monies being held for them.

For these reasons, and based on its track record, SoundExchange should maintain its position as the sole licensing collective.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 6/6/2014

Ron Wilcox

Exhibits Sponsored By Ron Wilcox

Exhibit No.	Sponsored By	Description
SX EX. 001-DR	Ron Wilcox	Exhibit 1 - Trial and Experimental Internet Simulcast and Webcasting Agreement with Clear Channel Communications, Inc. dated October 1, 2013
SX EX. 002-DR	Ron Wilcox	Exhibit 2 - First Amendment to Trial and Experimental Internet Simulcast and Webcasting Agreement with Clear Channel Communications, Inc. dated March 31, 2014

SX EX. 001-DR

RESTRICTED — Subject to Protective Order in Docket No. 14-CRB-0001-WR (2016-2020) Webcasting

SX EX. 002-DR
(Wilcox Ex. 2)

SX EX. 002-DR

RESTRICTED — Subject to Protective Order in Docket No. 14-CRB-0001-WR (2016-2020) Webcasting

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

TESTIMONY OF

AARON HARRISON

Senior Vice President, Business & Legal Affairs,
Global Digital Business, UMG Recordings, Inc.

PUBLIC VERSION

Witness for SoundExchange, Inc.

BACKGROUND

1. I am Senior Vice President, Business & Legal Affairs, Global Digital Business, UMG Recordings, Inc. ("UMG Recordings"), a position I have held since 2013. UMG Recordings, Inc. is the primary recorded music company in the United States for the Universal Music Group. Universal Music Group (hereafter, "Universal") is the colloquial name for the group of music related companies owned by Vivendi S.A. Together, these companies comprise the world's largest recorded music company. Along with other members of the Business & Legal Affairs team in the Global Digital Business department, I negotiate deals with various digital music services that use Universal's repertoire of sound recordings. Such services include on-demand and customized streaming services, download and ringtone stores, locker services, and various types of subscription services. I have negotiated deals on Universal's behalf for the past nine years. During that time, I have negotiated more than 100 agreements with digital music services.

2. Prior to assuming my current position, I was Vice President, Business & Legal Affairs, eLabs, UMG Recordings. I began my employment with UMG Recordings in 2005 as Director, Business & Legal Affairs, eLabs. Prior to joining UMG Recordings, I was an attorney with the law firm Manatt, Phelps & Phillips, LLP, where my practice focused primarily on talent representation and advising companies in the acquisition of intellectual property and branded entertainment rights. I started my career as an attorney at Munger, Tolles & Olson, LLP in 1999. I received a J.D. from Yale Law School and a B.A. in Economics from Pomona College. I am licensed to practice law in California.

3. I previously testified before the Copyright Royalty Board in 2012 in connection with the rate-setting proceeding for certain satellite and cable television services.

DISCUSSION

I. Universal's Position In The U.S. Music Industry

4. Universal's share of the U.S. recorded music market is approximately 38%. This includes the recorded music repertoire of UMG Recordings, as well as the recorded music assets previously owned by EMI Music. Universal acquired EMI's recorded music assets in 2012, and today our department handles agreements related to the online dissemination of all of this content.

5. Universal's recorded music holdings are comprised of an extensive and diverse collection of record labels, including A&M Records, Blue Note Records, Capitol Records, Capitol Christian Music Group, Caroline, Decca, Def Jam Recordings, Deutsche Grammophon, Geffen Records, Interscope Records, Island Records, MCA Nashville, Motown Records, Republic Records, Show Dog–Universal Music, Universal Music Latino, Verve Music Group, and Virgin Records. The artists who record for Universal labels include the best known and most popular recording artists in the world, including, among others, U2, Imagine Dragons, Maroon 5, The Black Eyed Peas, Drake, Bon Jovi, Mariah Carey, Ariana Grande, Dr. Dre, Kanye West, Alan Jackson, Tim McGraw, Keith Urban, Norah Jones, The Killers, Lady Gaga, Madonna, Lorde, Lionel Richie, Sting, George Strait, and Stevie Wonder. Universal's extensive catalog of sound recordings includes music by some of the most influential and legendary artists in the history of music, including Louis Armstrong, The Beach Boys, The Beatles, James Brown, Eric Clapton, Patsy Cline, Ella Fitzgerald, Marvin Gaye, Guns N' Roses, The Jackson Five, Lynyrd Skynyrd, Bob Marley, Nirvana, The Rolling Stones, Kenny Rogers, Frank Sinatra, and The Who.

6. Universal also has an extensive international presence, operating through affiliated companies, joint ventures, and other entities authorized to disseminate its content in more than 70 countries worldwide.

II. Universal's Approach To The Market For The Distribution Of Recorded Music

A. The Shift From Ownership Model To Access Model

7. The market for recorded music continues to change at an extraordinary pace. This change has accelerated greatly within the last five years. That change likely will continue even more rapidly over the next five years. In particular, we are in the midst of a highly accelerating transition from the traditionally dominant "ownership" model of consumers acquiring recorded music to a model that will be predominantly "access."

8. The "ownership" model is one in which the consumer purchases a copy of a particular piece of recorded music, traditionally an album (whether on vinyl, cassette, or CD) or, in more recent times, a permanent download through an online retailer such as the iTunes Store. Once purchased, the copy of the music would reside in the consumer's music "library," either in a record collection, on a hardware device (such as an iPod), in a cloud collection on a locker service's remote servers (such as iTunes Match), or some combination of the three. For a full album permanent download sold on iTunes, the range of return to Universal is between [redacted], after paying the expense of music publishing rights for between ten and twelve songs on the album. When the consumer purchases a single permanent download track, the return to Universal generally would be around [redacted] or [redacted], after paying the expense of music publishing rights, for single tracks with a retail price of $0.69, $0.99, or $1.29.

9. In contrast, in an "access" model, consumers do not obtain permanent copies of sound recordings, but instead utilize services that play recordings for listeners. Over the last

decade numerous services that digitally stream music to consumers have come into being and gained in popularity. These services provide materially different types of access to musical content. A number of these services are "on-demand," meaning that, among other features offered, the service allows users (or subscribers) to choose the immediate next song that they will hear and create playlists of songs in the exact order in which they want to listen to them. Some well-known on-demand services are Spotify and Rhapsody. Other such services offer programmed, customized, or personalized webcasting. Examples include Pandora, Slacker, and iHeartRadio.

10. For purposes of understanding the shift to an access model from an ownership model, a particularly important development is the deployment by webcasting services of customized, or personalized, offerings. Customized webcasting services transmit individual recordings to individual users. In addition, customized services utilize computer algorithms to respond to the preferences of individual users, so that, although the user may not be able to select the precise track that will be streamed to his or her device, the user can significantly narrow, or "fine tune," the music that he or she will hear. This can be done in a variety of ways, including expressing "likes" or "dislikes," such as "thumbs up," or "thumbs down," or using interface controls that ask the service to play certain music more, or less, like the track the service is streaming to the user at that moment. If a user has "customized" her or his preferences through a streaming service, the user knows they have a good chance of hearing songs they like, or others like them, and thus see a diminished need to own the particular recording.

11. Over the past few years, we have grown to understand that neither on-demand nor customized streaming services promote sales of recorded music. To the contrary, our observations of the market, especially over the last year, have been that these services are

drawing consumers and revenue away from the sale of permanent downloads and CDs. The most visible example of this and the market's transition away from an ownership model to an access model is the rapid decline in permanent download sales. January is typically our biggest month for download sales because iTunes gift cards are a common holiday gift. In January 2014, however, we saw a 20% decline in download sales from the prior January. Since January, the rate of decline has decreased somewhat from the prior year, but it is still 18% year-to-date. Conversely, the number of listener hours on customized and on-demand streaming services rose substantially over the same period. This imbalance—with higher streaming hours and significantly reduced download sales—has provided further confirmation to us that on-demand and customized streaming services do not promote sales of downloads. Rather, the widespread access to such streaming music services has helped to accelerate the decline in purchases of permanent downloads. As a result, Universal is depending more and more on revenues from all types of streaming services.

B. The Importance Of Revenue-Generating Access Services To Universal's Ability To Recover Its Substantial Investments In Recorded Music

12. As a consequence of this shift from an ownership model to an access model, revenues from streaming services have become increasingly important to Universal's ability to recover the substantial investments it makes in the discovery and development of recording artists, and the production and marketing of recorded music. Going forward, we will not be able to rely on revenues from the sale of permanent downloads or CDs. Thus, revenues obtained from streaming services will need to increase to ensure Universal receives a fair return on its investment in the creation of music. This is not only fair, it is sound economics. Universal's repertoire (along with other music) serves as the foundation upon which each of these services is built—without the music, these services would not exist.

13. In our experience, a service's ability to return sufficient value to Universal depends on the amount of average revenue per user ("ARPU") the service can generate. In particular, we have found that streaming services cannot generate sufficient ARPU through advertising alone. This is in part because streaming services are reticent to play advertisements at the same frequency as terrestrial radio. Most streaming services play an average of 3 minutes of advertising per hour, compared to the 10-15 minutes per hour for terrestrial radio. According to publicly available information, Pandora plays only an average of 1.5 minutes per hour. Publicly available statements from streaming services reflect the services' predictions that advertising revenues will grow as advertisers become more comfortable with the audience that the services reach. However, webcasting services have been slow to increase advertising inventory because they are currently focusing on growth in number of users and listener hours, rather than monetization and profit. Therefore, we have not yet seen advertising generate substantial revenues for services and, in turn, substantial revenues to Universal. For this reason, we require minimum advertising loads in our direct deals for ad-supported services, as well as a path to conversion to paid subscription. For example, in our agreement with [redacted], we require the service to play a number of advertisements per hour that increases with the number of months the user has been listening to the service. For a user that has been listening to the advertising-supported service for [redacted] months, the service plays a minimum of [redacted] of advertising per listener hour with at least [redacted] within the first [redacted] of the session. For users on the service from [redacted] months, the requirement increases to [redacted] and for users on the service longer than [redacted] months, the requirement increases to [redacted].

14. Subscription offerings, in contrast, can generate a higher ARPU. In Universal's direct deals, it shares in this higher ARPU. Consumers are willing to pay for a subscription to a streaming service for multiple reasons: subscriptions can allow users to avoid advertising, to access streams at a higher level of sound quality, to listen to music offline, or to be able to hear a song or album on-demand. Advertisers, on the other hand, do not necessarily pay higher rates for the additional features that come with a subscription; rather, they pay for traffic numbers and time spent listening. Universal prefers to do deals with services that drive toward subscription versus non-subscription services because the former are able to generate monetary value, in the form of higher ARPU than non-subscription services, and accordingly generate more significant returns to Universal in exchange for the right to exploit Universal's repertoire. As explained more fully below, Universal generally negotiates conversion incentives or other structural mechanisms that ensure the service encourages users to subscribe.

15. On-demand subscription services generally return an ARPU in excess of [redacted] per month to Universal, or [redacted] per year. Subscription services also pay much higher effective per-play rates, averaging more than [redacted] per play for on-demand services and close to [redacted] per play for those programmed services with which we have direct licenses. Thus far, the most prominent webcasters have operated predominantly non-subscription services. Those that do have subscription services, such as Pandora, appear to have made a business judgment not to encourage users to subscribe. Even if statutory services did encourage subscriptions, Universal and other rightsholders would not share in this revenue because the statutory rates are only a per performance fee, not a greater-of per performance and share of revenue.

16. Our approach to the terms on which we will authorize subscription streaming services to use our repertoire continues to evolve. In prior years, Universal was willing to authorize the right to stream its repertoire to a substantial number of services without significant restriction. As revenue from streaming services becomes much more important to Universal's overall revenue, growing from [redacted] to [redacted] of Universal's digital revenue over the last five years, we have become more deliberate than in prior years about the terms on which we will authorize the use of our repertoire for such purposes. In particular, we seek to ensure that services to which Universal grants the right to use sound recordings will generate revenue and not just divert revenues from other forms of exploitation, including from higher ARPU subscription streaming services. For example, although revenues received through SoundExchange from Pandora make it [redacted] source of revenues in the United States, its ARPU is particularly weak. To Universal, this suggests that Pandora is streaming music to users who might otherwise pay for a subscription or use a higher ARPU streaming service. For this reason alone, Universal would never do a deal with Pandora at the rates it currently pays.

III. Influence Of The Statutory License On Universal's Deals With On-Demand Streaming Services

17. Most of Universal's directly negotiated agreements with streaming services are for services that want to offer "on-demand" streaming. The statutory rates have less of an influence on Universal's negotiations with on-demand subscription services than Universal's negotiations with webcasting services. I believe these agreements therefore are a better proxy for market rates than agreements with services whose functionality either makes them eligible for the statutory license, or that could be changed to become eligible for the statutory license without significant disruption to the service's mode of operation.

18. Nonetheless, the statutory rates are always in the background of our negotiations with on-demand services and have had a downward influence on the rates over the last few years. These negotiations are anchored by the statutory license because on-demand subscription services compete with statutory services for large portions of the same base of users. Because on-demand services like Spotify compete directly with statutory webcasters like Pandora, our directly negotiated rates have fallen over the past few years in response to the low statutory rates. Unless the statutory rates are set closer to the market rate for streaming services generally, on-demand rates will likely continue to fall to bring about parity in the market. As a result, I believe the statutory rates need to increase over the next rate term to reflect the fact that customized webcasting services are becoming more and more personalized and competing directly with the on-demand services.

19. Notably, many services offer both on-demand and programmed or customized streaming. While such services may have the ability to elect the statutory license for the latter under 17 U.S.C. § 114, companies offering both services frequently negotiate with Universal for authorization to stream Universal sound recordings on both services. It has been our experience in negotiations that on-demand subscription services whose consumer offering feature an ad-supported, customized webcasting "tier" strongly resist rates for such tiers that are higher than the statutory rates. It also has been Universal's experience that such services will seek rates for their customized webcasting tiers that are *lower than* the statutory rates, both because the services provide Universal with additional consideration through other deal terms such as usage data and marketing analytics and because the customized webcasting tier is used as a tool to convert free users to the paid on-demand service. For example, during negotiations with

[redacted], the service took the position that its rates should be discounted because it intended to use the webcasting tier of service to upsell users to the subscription tiers.

20. In addition, parties with whom Universal negotiates can and do use the threat of transforming their operations to fall within the statutory license as grounds for seeking reductions in the rates or other forms of consideration provided to Universal. An example of this phenomenon can be found in Universal's recent negotiation with Slacker Radio. Slacker Radio currently offers three tiers of service:

- **Slacker Basic Radio:** an ad-supported tier, the functionality of which closely approximates the functionality found in services operating under the statutory license;
- **Slacker Radio Plus:** a subscription tier for $3.99 per month that has no advertising, no limit on the number of skips, and permits users to play stations offline;
- **Slacker Radio Premium**: a subscription tier for $9.99 per month that has all the features of the Plus tier, but also permits on-demand plays and allows users to create their own playlists.

[redacted] This threat was made after Last.fm did in fact opt to go through SoundExchange after the direct deal with Universal expired.

21. In sum, based on Universal's experience, the availability of the statutory license has a significant effect on the rates that Universal will receive for streaming services' exploitation of its repertoire.

IV. Important Terms In Universal's Direct Deals With On-Demand Streaming Services

22. In this section, I explain how Universal approaches its negotiations for direct deals with on-demand streaming services and what Universal aims to receive in consideration through those negotiations. I also provide examples from concluded agreements of how Universal has been able to achieve some of these objectives. It is important to emphasize at the outset that, although we have clear priorities in negotiating, Universal is not rigid in its approach to deal-making. Through negotiations with our streaming service partners, Universal attempts to achieve an optimal overall return to Universal for the use of its repertoire.

23. Universal's goal is to create meaningful strategic partnerships. In this endeavor, we look for a service that has a strong business plan for growing ARPU. Before we go forward with any direct negotiations with new services, we ask them to fill out a "new partner questionnaire" which allows us to better evaluate their business plan. We ask about their funding sources, their management, their business model, plans for scaling the service and increasing revenues over time, as well as how they will distinguish their service from others on the market. I have attached a copy of our questionnaire as Exhibit 1 to my testimony. We also conduct diligence on the business model and financial stability of the prospective partner. We view the value to Universal of our direct deals based on the entirety of the agreement. In particular, the stated royalty rates alone do not capture the full value that Universal receives from these deals.

24. In the sections that follow, I will describe some of the types of monetary consideration that Universal receives from its direct deals, then I will describe some of the non-monetary terms that provide substantial value to Universal.

A. Universal Obtains Substantial Monetary Value From Its Direct Deals With On-Demand Services.

25. In general, Universal's direct deals share several key features that are important to understanding the overall consideration that Universal receives. First, we work to obtain rate structures that not only ensure a minimum level of compensation to Universal, but also a potential to share in the upside of services that are built on our repertoire. Second, Universal ties the rates to advances, minimum guarantees, flat fees, and shortfall payments that set expectations for the service's performance. Third, Universal seeks marketing and promotional guarantees that ensure that the service compensates Universal proportionately to its market share.

(a) Rate Structure and Rates

26. One of the most important aspects of our direct deals is that they provide a rate structure based on the "greater-of" several different methods of calculating rates. Universal almost always requires a greater-of rate structure because it both guarantees a minimum level of compensation for the use of Universal's music and it gives us a chance to share in the upside of a successful service. Within the greater-of structure, one or two of the tiers are "floor" rates, either a minimum per play or a minimum per subscriber. Per play fees in particular compensate Universal for the intrinsic value of our music and the fact that consumption of music on any platform takes away from consumption of music elsewhere. The per play fee is crucial to an ad-supported or otherwise free-to-the-consumer service to ensure that the service has an incentive to monetize its user base. For the subscription tier of a service, Universal has moved away from requiring per-play fees. However, Universal insists on a minimum share of per-subscriber revenue that results in an effective per play rate.

27. The other component of the greater-of rate structure is Universal's proportionate share of the service's gross revenue. If the service is successful, we believe that we are entitled

to share in that success, because music is the single most important ingredient on which the service builds its business. Universal's deal with [redacted] illustrates a typical rate structure for an on-demand subscription service with a free-to-consumer offering and a premium mobile offering. This deal also offers an annual discount and a discounted family plan, which are aspects of several of our deals. The rate structure is as follows:

[redacted]

I have included a copy of this agreement as Exhibit 2 to my testimony.

28. In the United States, Universal does not have a single agreement with an audio streaming service that does not include a greater-of rate structure. If we negotiated a deal on a pure percentage of revenue, we would require a substantial minimum guarantee to ensure adequate compensation for Universal's music. Likewise, if we did not have the opportunity to

share in the upside of a successful service, we would seek higher per subscriber or per play compensation.

29. Closely tied to the rate structure are conversion incentives for subscription services that offer a free-to-the-consumer tier. If the service wants to offer a free-to-the-consumer tier, we require built-in conversion incentives to ensure the service pushes consumers toward the higher ARPU service. For example, as mentioned above, our deal with [redacted] includes certain conversion incentives as follows:

[redacted]

30. Universal also requires a per play or per user minimum to protect against the risk that the service would defer revenue from these free users while actively seeking to gain market share. For example, [redacted] I have attached this agreement as Exhibit 3 to my testimony. These free-to-the-consumer rates must be viewed in conjunction with the higher per subscriber minimum. Universal would never offer such rates on a stand-alone basis. When Universal did enter into deals with streaming services without a subscription component, the per play rate was between [redacted] and [redacted] per play. Today, these services typically do not generate sufficient

ARPU. and. as a result. Universal prefers to focus on subscription services that provide a greater return on its investment.

31. Within the greater-of rate structure. Universal generally seeks the following rates: First. for the per play floor. Universal generally seeks a per play minimum of [redacted] for on-demand subscription services and above [redacted] for non-subscription services. Second. for the revenue share. Universal generally seeks its share of [redacted] of revenue. This share of revenue is purposeful. It roughly approximates the percentage of revenue that Universal receives for the sale of a permanent download. Third. for the per subscriber floor. Universal generally seeks a per subscriber minimum tied to the consumer price. usually Universal's share of a [redacted] label pool per subscriber for a $10 per month subscription service. These numbers also reflect the labels' collective share of the service's revenue. For example. when the revenue share for a service is [redacted] the per subscriber minimum is generally [redacted] and when the revenue share is [redacted] the per subscriber minimum is [redacted]. Occasionally. Universal will combine the per subscriber share with a non-pro rata per-subscriber minimum to ensure that the royalty reflects Universal's market share. For example. Universal's agreement with [redacted]

[redacted]

32. These stated rates are not how we ultimately value the consideration received. Rather, we calculate "effective" rates that incorporate these rates, but also all the other consideration to achieve an overall value that is generally higher. On an effective rate basis, virtually all subscription services pay Universal more than [redacted] per play.

(b) Advances, Minimum Guarantees, Flat Fees, and Shortfall Payments

33. Universal seeks compensation in the form of advances, minimum guarantees, shortfall payments, and flat fees. These terms mitigate the risk that a service will fail, underperform, or try to "game" the contract. We calibrate these payments so they are both achievable for the service but also enough of a stretch to ensure the company will invest and grow their streaming business. To set the appropriate advance or minimum guarantee, we use the service's own projections of future revenue. The amounts of these payments therefore are calibrated to what we and the service expect it will pay over the term of the agreement. Sometimes, we allocate a specific minimum guarantee to a service offering to ensure that the partner will invest in growing that business. For example, our agreement with [redacted] allocated [redacted] that was only recoupable against the [redacted] offering in 2012 and [redacted] for 2013. In the case of the [redacted], this allocation reflected the offering's actual performance.

34. Overall, these guarantees have proven to be successful forms of consideration for both parties. When these tools are not successful, we often work with partners to allow an advance to be recouped over a longer term. For example, [redacted]

[redacted] For Universal, the most important aspect of these forms of consideration is having it upfront and guaranteed which minimizes our risk in the partnership.

35. Universal's effective rate calculation takes into account the total value, including these upfront and true-up payments. Because the statutory license does not come with any advance or minimum guarantee of payment, the statutory rates must be higher to match the market value for this form of guaranteed consideration.

(c) Marketing and Promotional Guarantees

36. Universal also derives significant value from enhanced marketing and promotion of Universal artists. Although not as easily quantifiable as direct cash payment, enhanced marketing and promotion is quite valuable consideration for the use of Universal's content.

37. Enhanced marketing commitments can take a number of forms. Some commitments ensure promotional commitments for Universal artists relative to promotion the services provide to other rights owners. For example, our agreement with [redacted] Provisions such as this provide significant value to Universal, vis-à-vis support that a service might otherwise use in favor of Universal's competitors. In the physical space, Universal used to pay retail stores co-op advertising fees to ensure better placement of our music and increased promotion of our

artists, but we now obtain those commitments directly in our agreements with streaming services.

38. Universal will often negotiate for mandatory spends on marketing the service itself. For example, [redacted] For a new or emerging service, this is an investment that is mutually beneficial because it reduces the likelihood that the service will fail and creates additional opportunities for showcasing Universal artists.

39. Ultimately, these marketing and promotional guarantees have monetary value because Universal does not need to buy advertisements on the service or otherwise target the service's users. For example, [redacted] The market price for this advertising, [redacted] Accordingly, Universal considers this to be additional monetary consideration not available under the statutory license.

B. Universal Obtains Substantial Non-Monetary Value From Its Direct Licenses.

40. In addition to the monetary consideration received, Universal obtains substantial benefits in the form of non-monetary consideration from its direct deals with on-demand services. Although we cannot easily assign a value to these benefits, without many of them—most notably, holdback rights, user data and security precautions—we would not authorize the use of Universal's sound recordings. None of these benefits inheres in the statutory license.

Because any compliant service can obtain a statutory license for Universal's sound recordings, the rates should be higher to compensate for the lack of these common benefits generally included in our direct deals.

(a) Short Deal Terms

41. Universal's direct deals average in duration from one to three years. Generally, we seek a two-year term or less to ensure that we can adapt as the market evolves. We would never risk a five-year deal term—the length of the statutory rate period, except in extraordinary circumstances. It is important that the statutory rates account for the risk that Universal and other content owners would face if the rates were set too low. If the rates are set too low, Universal has no ability to opt-out of the statutory license. This would put both Universal and the interactive streaming services with which it partners in a very difficult place until royalty rates could be reset to match the market price. However, if the rates are too high, services have the option of opting-out of the statute and doing direct deals at market rates. Although a statutory rate above market rates would give us some negotiating leverage, ultimately, it would be in our interest to find a rate that enabled the service to grow and be profitable.

(b) Holdback Rights

42. [redacted] As we see the market evolving, we see holdback rights becoming a more important aspect of our partnerships. One clear way to drive users to a service is to offer an exclusive release on that service. Moreover, we could help a service encourage subscriptions by offering specific content to subscribers only. Unfortunately, statutory services can gain near immediate access to sound recordings once we

have publicly distributed phonorecords of those sound recordings, thereby undermining the effectiveness of either strategy.

43. [redacted] For example, our agreement with [redacted]

(c) User Data

44. Increasingly, we have found that user data is one of the single most important benefits of our partnerships with streaming services. Among other sources of information, we are able to obtain user data that shows the geographic regions in which specific artists are popular or are gaining popularity. We can also see which artists appeal to certain demographics (by age, gender, type of device used, etc.). The data that partners provide to us can indicate when a track from an album is gaining in popularity such that Universal should consider releasing it as the next single. Information regarding user behavior is crucial to helping Universal and our artists understand how their music is being received by their fans and decide where to target marketing efforts and where to tour.

45. Universal employs a full analytics team of approximately forty people. This team devotes their time to analyzing the data for trends that help us make well-informed decisions

regarding how to promote certain artists. To illustrate how important user data is to Universal, we have entered into a strategic partnership with [redacted] In that deal, we agreed to waive our standard [redacted] per track content delivery fee in exchange for the data, which amounts to more than [redacted] for our full catalog. Although statutory services are required to report the tracks that they have played so the royalties are properly distributed, they do not report any user data information. Accordingly, this is a benefit that Universal regularly receives in the market but that is not available under the statutory license.

(d) Security Guarantees

46. Security precautions are potentially priceless because they protect Universal's single most valuable asset: its catalog of sound recordings. Security guarantees are especially crucial for Universal to be willing to authorize the use of its content given that unscrupulous online companies have spent more than a decade enabling the mass pirating of our content. Before we finalize any agreement, we ask the service to submit a technical white paper on their security protocols. Our Advanced Technology staff of four engineers and computer scientists spends weeks investigating each streaming service's ability to protect our content on its servers and to deliver content to users in a way that prevents capture or download. Adherence with these protocols then becomes a condition of the agreement.

47. We have extensive security requirements. By way of example:

- We require that services not partner with peer-to-peer sharing services;
- We require services to take active steps to stop piracy, including by using encrypted streaming or true streaming;

- We also require our partners to use territorial filtering that prevents individuals from accessing a service if it is not offered in their territory;
- We require services to have an anti-hacking policy and to monitor their system for any security breaches and immediately inform Universal if one has occurred; and
- We require the service to implement an end user agreement that requires users to comply with all security measures and agree to not make any infringing use of the music as a term of use.

48. While the statute prohibits any affirmative act to facilitate reproduction of phonorecords, it does not prevent webcasting services from keeping files in insecure locations or from delivering those files to users as unencrypted progressive downloads, which are much easier to capture than true streams or encrypted progressive downloads (our minimum requirement in direct deals). The statute is also silent on other security protocols that are standard in our direct deals, such as territorial filtering. We recently became aware that a number of NPR digital stations are available outside the United States, but Universal has no recourse to limit the streaming because there is no contractual relationship with NPR.

49. To remedy some of these security risks, Universal has entered into agreements with statutory services to provide them content directly in exchange for a relatively small content delivery fee and security guarantees. For example, iHeartRadio stations must comply with our security and territorial filtering requirements to maintain access to our direct United States content feed. Although we have directly negotiated for security guarantees and content delivery fees with certain statutory webcasters, the statutory license does not mandate that we will receive this benefit.

(e) Fan Engagement

50. Universal also looks for ways to engage fans through the services. In addition to the marketing guarantees described above that require the service to include Universal artists in

its promotional materials, we also seek to access fans directly. Several of our agreements include a term that gives Universal access to the email addresses of users. For example, [redacted] We spend over [redacted] per year to maintain our email database. In addition, Universal seeks to include label-specific pages or playlists on services. These pages and playlists allow Universal's record labels to directly reach fans and give exposure to up-and-coming artists.

V. Universal's Direct Deal with Nokia Mix Radio Is Unique

51. In 2012, Universal entered into a direct agreement with Nokia for a customized webcasting service that would be bundled with Nokia devices. The idea was for Nokia to have a brand-specific music streaming service to help differentiate its phones. The service launched with a free-to-the-consumer streaming service available to each user owning a Nokia device. As a requirement of our deal, [redacted] The premium subscription service, known as MixRadio Plus, launched in 2013. The consumer price for the premium service is $3.99 a month for unlimited skips, unlimited offline listening and higher sound quality.

52. Although Nokia's webcasting offering is similar to that offered by statutory licensees, our deal was unique and very different from a statutory license for a number of

reasons, including that the fees Nokia pays Universal are [redacted], and we authorized Nokia to provide limited caching of sound recordings. The fees that we receive from Nokia are as follows: For the Basic MixRadio service, we receive [redacted] For MixRadio Premium service, we receive [redacted] I have attached this agreement as Exhibit 4 to my testimony.

53. Earlier this year Microsoft purchased the Nokia service and has recently spun it off into a separate company. We are currently negotiating the terms of a new deal.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: October 6, 2014

Aaron Harrison

Exhibits Sponsored By Aaron Harrison

Exhibit No.	Sponsored By	Description
SX EX. 003-DR	Aaron Harrison	Exhibit 1 - New Partner Questionnaire
SX EX. 004-DR	Aaron Harrison	[redacted]
SX EX. 005-DR	Aaron Harrison	[redacted]
SX EX. 006-DR	Aaron Harrison	[redacted]

SX EX. 003-DR

RESTRICTED — Subject to Protective Order in Docket No. 14-CRB-0001-WR (2016-2020) Webcasting

SX EX. 004-DR

RESTRICTED — Subject to Protective Order in Docket No. 14-CRB-0001-WR (2016-2020) Webcasting

SX EX. 005-DR

RESTRICTED — Subject to Protective Order in Docket No. 14-CRB-0001-WR (2016-2020) Webcasting

SX EX. 006-DR

RESTRICTED — Subject to Protective Order in Docket No. 14-CRB-0001-WR (2016-2020) Webcasting

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

TESTIMONY OF

JEFFREY S. HARLESTON

General Counsel and Executive Vice President
for Business and Legal Affairs for North America
for Universal Music Group

PUBLIC VERSION

Witness for SoundExchange, Inc.

I. BACKGROUND AND QUALIFICATIONS

1. My name is Jeffrey S. Harleston. I am the General Counsel and Executive Vice President for Business and Legal Affairs for North America for the group of companies that are known as the Universal Music Group (collectively, "UMG"). In that capacity, I oversee all of the legal functions for UMG in North America, and I serve as a member of UMG's senior management team.

2. I have worked in the music business for more than twenty years. In 1993, I joined the record label MCA Records as an Associate Director of Business and Legal Affairs. MCA Records later became a part of what is now UMG. Between 1993 and 2003, I held several different positions within the MCA Business and Legal Affairs department, with increasing responsibility for increasingly complex deals. My initial responsibilities were primarily focused on negotiating and drafting artists' recording agreements. By 1999, I had become the head of the Business and Legal Affairs department for MCA.

3. In 2003, I became the General Manager of Geffen Records after Geffen merged with MCA Records. As the General Manager, I was involved in all aspects of the record business – from the creative side to the business side. I worked with a number of chart-topping artists, including Mary J. Blige, Common, Nelly Furtado, Ashley Simpson and Snoop Dogg. In 2008, I moved back to the corporate offices of UMG and rejoined the Business and Legal Affairs department. I have served in my current role since 2010.

4. I received my Bachelor's degree from Williams College. I graduated from Boalt Hall, the law school of the University of California at Berkeley, in 1988.

5. In this testimony, I will describe the creative process of a record label's business, the significant investment involved in developing new music, as well as the inherent risks

associated with our business. I will also highlight some of the major cost categories in our business. Of course, the particular path from discovery to the release of an artist's first record will vary – across artists, genres, and labels. My goal in this testimony is to describe a typical path from discovery to release – not every path.

6. The reason for detailing our significant effort, investment and the attendant risks in creating and releasing sound recordings is simple: record labels and artists bear the risk of a record succeeding or failing. If a considerable investment in a new artist is lost, the digital service providers who play our music do not bear that loss. Our digital partners will continue to benefit by having the ability to play our music that is popular—without having to bear any of the risks inherent in creating it, and without having to bear any of the losses we incur in artist investment. Digital services that build their business on our content should pay a fair price for that content that appropriately reflects this disparity in creative contribution, investment, costs and risks.

II. UMG

7. UMG today is the largest record company in the world. It is the home of scores of well-known record labels that produce music from across every genre: Motown Records, Interscope Records, Island Records, Def Jam Records, Geffen Records, A&M Records, Capitol Records, Virgin Records, Mercury Nashville, Universal Music Latino, Verve Records, Republic Records, Universal Music Classics, and many more. Our catalog includes some of the most significant recordings in history, including recordings by greats like The Beatles, Ella Fitzgerald, Louis Armstrong, James Brown, The Who, Stevie Wonder, Patsy Cline and Johnny Cash. Our labels have signed and marketed some of today's most successful acts, including U2, Katy Perry, Rihanna, Lady Gaga, Imagine Dragons, Ariana Grande, and Eminem.

III. THE WORK OF A RECORD LABEL

8. Record labels discover, create, produce, market and sell music. We are the engines that power the entire music industry, by releasing new music and making sure it gets into the hands of consumers every day. Right now, our company is (we hope) in the process of discovering your next favorite artist, or honing the recording of what will be your next favorite song. But that process of discovering new music and positioning artists to reach mainstream success is an art, not a science. Finding artists, working with them to create new music, marketing that music, and getting it into the hands of consumers involves significant investment and is fraught with unique risks.

A. Artists & Repertoire (A&R)

9. Our work creating the next, big hit record begins in the A&R Departments of our labels. The A&R Departments are responsible for discovering, nurturing and delivering new talent to our labels. A&R representatives search the country for new artists. They listen to thousands of demonstration recordings ("demos"), scour the Internet, conduct market research, attend live shows, and meet with artists and their managers. A&R representatives often use their understanding of music and industry trends to identify those artists with substantial talent. But talent is just the beginning. Artists we ultimately sign also typically have something unique about them that we believe would make them compelling to a larger audience. We are always looking for a new sound, and a new fresh persona to go with it. The trick is in finding an artist that is new and fresh and unique – but not so new that the world is not yet ready to embrace them.

10. Out of the hundreds of talented artists identified by our A&R scouts every year, only a small fraction of them are ever signed to a recording agreement. Committing to an artist

requires a huge investment of money – not to mention considerable time and effort. We do not make that commitment lightly. Every artist – even an established artist – poses a financial risk. The only question is one of degree. In deciding whether to sign a new artist, we must assess not only whether the artist's music is marketable, but whether the artist also is marketable. Very rarely does a new artist present themselves to us with a fully realized image that we believe is likely to gain mass appeal without tremendous work and effort. We must consider what type of investment we will have to make in that artist to get both the artist and their music to a place where we expect the public to accept and love them. Those efforts can include all kinds of financial investment in creating the complete package: dance and vocal lessons, personal stylists, makeup artists, trainers, media training, etc. can all be a part of the process and the investment we make in a new artist in whom we believe.

11. As the department charged with maintaining an ongoing pipeline of talent to create new products, the A&R department at a record label is similar to the "research and development" departments of other consumer product companies. And as with "R&D" efforts in other industries, these efforts are very expensive. Our A&R departments incur significant costs that represent extensive investment in our future. In fiscal year 2013, we spent a total of [redacted] on gross A&R expenditures, including both overhead and payments to third parties.

B. Business and Legal Affairs

12. Once the decision has been made to sign an artist, the Business and Legal Affairs department takes over the process of negotiating and entering into an artist recording agreement. This process can be complex. Often numerous record labels are in competition for the same artist. The more competitive a prospective signing, the more complex the deal negotiations are likely to be and the more expensive the deal will be.

13. Our recording agreements differ and are individually negotiated, but the relationship between the artist and his or her label is typically structured in the following way: The record label fronts all of the costs of recording, mixing and mastering a record. Record labels also typically offer an advance to attract the artist to their label. The artist also receives a share in the proceeds from the label's exploitation of the artist's recordings in the form of royalties. If the artist is very successful, then both the record label and the artist reap the benefits. Artists receive royalties only after the advance and recording costs have been recouped by the label. But if the artist does not achieve a high level of success – as is often the case – then the record company must absorb the loss. As an example, our 2013 income statement reflects [redacted] in advances for new artist signings and write offs from established artists -- net of recoveries.

C. The Production and Recording Process

14. Once an artist has been signed, the process of making an album begins. The A&R department, most likely the A&R representative who signed the artist, oversees this process. The pre-production phase focuses on selecting the material to be recorded. A&R representatives often work closely with artists to sift through their material and develop the most promising ideas into songs that the A&R representative believes can comprise a successful record.

15. The A&R representative also frequently works to match an artist with the right combination of producer and studio that best suits that artist. For some hip hop and pop artists, A&R representatives may sift through as many as thousands of rhythm tracks to attempt to find that perfect pairing of artist with producer and studio. The right combination of artist and producer can be invaluable in helping to propel an artist to superstardom.

16. A&R representatives will also put artists together to collaborate with other artists. That can be a very effective means of introducing artists to another artist's fan base. As an example of this phenomenon, consider the recent release "Bang Bang," a huge hit that combined the efforts of Ariana Grande, Jessie J, and Nicki Minaj. The track is featured on both Ariana Grande's second album, "My Everything," and as the first single off of Jessie J's second album, "Alive," released in September. When these artists combined their efforts, their respective fan bases were exposed to each artist. Ariana Grande and Jessie J's immense fan base of pop listeners became exposed to the more hip hop leaning rap style of Nicki Minaj and vice versa. Another example that has succeeded on more than one occasion is the combination of Rihanna and Eminem, who recorded together for the first time on the hit "Love the Way You Lie." As a consequence, Rihanna's pop audience gained favorable exposure to Eminem, and Eminem's rap audience was introduced to Rihanna.

17. A&R representatives also assist in making sure that the other musical elements of a recording session are in place: they ensure that the right session musicians are hired, as well as background musicians, vocalists, etc. These are musicians and vocalists who are hired to work during the recording session. The A&R administration department manages the business and administrative aspects of getting the record made: reserving and paying for studio time, covering and arranging travel expenses, renting equipment, etc.

18. Once the material has been chosen, the producer chosen and the studio time booked, the artist is ready to record. The A&R representative typically continues to be involved throughout the recording process, to make sure that the sessions run smoothly, to be someone that the artist can bounce ideas off of, etc.

19. In the process of recording an album, oftentimes more tracks will be recorded than ultimately will be used on the album. Therefore, after recording sessions for an album have concluded, the A&R representative and others at the label may work with the artist to decide which tracks should be included on the album release. The remaining tracks which were not included on the "basic" version of the album can still play a significant part of the marketing plan for an album. For example, major retail partners – like Best Buy, Target, Wal-Mart, etc. – often ask us to include specialized, exclusive content on the albums available for sale via their stores. The exclusive use of tracks not available elsewhere helps distinguish the products sold in one store versus another. In addition, as the recording process concludes, the Art, Marketing and Production departments begin to work with the artist to design artwork and take photos to set the visual themes for the album.

20. The recording process requires significant investment of financial resources. While the costs of putting an album together generally are recoupable from artist royalties, there are no royalties if an album does not generate revenue through sales or streams. The record label bears the risk of losing all of these upfront costs. For a brand new artist, we can easily spend up to [redacted] before we put an album out in recording costs and advances. (We also spend considerable amounts of money on marketing the album, but I will address that later.) The record label has made a significant investment of both time and money, and taken a considerable financial risk long before it can know whether an artist is going to be a commercial success. And, unfortunately, most of the time for new artists, that risk does not pay off. Although record labels hope that all of their artists will be highly successful, based upon their experiences, they operate on the principle that out of every ten artists signed, only one is likely to succeed. As a result, the success stories must pay for the costs of those other efforts that do not end as well.

21. Our odds of success improve with an established artist, but the expenses we incur and the investment we make also substantially increase. In the case of an artist with a track record, the recording process tends to be much more prolonged and expensive, and we typically pay larger advances. The pre-release costs for an established artist can run in the [redacted]. And as I discuss further below, in our business, prior success is no guarantee of future success.

D. Marketing

22. The process of marketing and promoting an artist is a creative endeavor that calls upon a record label's music industry expertise. Our marketing professionals help an artist develop and define their image and style, and through that find their niche in the marketplace. Through the unique marketing plan designed for each artist, we create opportunities for the artist to communicate their message. And our promotion staff works to identify opportunities to garner exposure for that artist.

23. Our promotion departments use their expertise to develop pathways of discovery and exposure for our artists across all media platforms. Our goal is to create awareness among consumers about the artist's music, and to increase interest and excitement surrounding the artist to incentivize consumers to purchase the music. We use our expertise to help each artist build a buzz that is engineered to "break" that artist to specific demographics. Our methods of marketing and promoting artists vary depending on the style and genre of the artist we are marketing and promoting. For some artists, we may emphasize their social media platforms and their artist websites. For other artists, we may employ marketing methods aimed at building a viral, "street" buzz. For still others, we may focus on putting together exactly the right tour. For

all of our artists, we work to get them out in front of the public in a way that will get them noticed, and will make consumers want to acquire the artists' music.

24. Our marketing and promotion staff includes experts across several different departments. We have video departments that work with the artist and video directors to deliver an audio-visual interpretation of the recording. The challenge is to ensure that an artist's music videos are creative and exciting, and developed consistently with the artist's genre and image. Music video production costs are one of the most significant marketing costs we incur.

25. We have artist development departments that work with artists and their management to identify touring opportunities and coordinate all of the various marketing efforts on behalf of that artist while the artist is out on the road. We have in-house publicity staff that works with media outlets and supervises the work of outside publicists engaged for particular projects. We have sales departments at each of our labels and at our distribution company who work to ensure that our artists' products are available to the consumer and positioned in the best way possible to succeed. And we have new media staff who are responsible for marketing artists on the Internet through social media and other tools. All of our efforts are aimed at creatively making certain that an artist is able to reach the customers who are likely to buy their music.

26. As in decades past, our marketing and sales efforts include working with our brick-and-mortar retail partners to make certain that the record is visible in stores. We employ marketing materials like stand-ups, cardboard cutouts and posters featuring the artist. We feature the artist in Sunday newspaper circulars for retailers like Best Buy, spotlighting new releases for that week. We plan for and ensure that an artist's new release is featured on the "end caps" in the retail stores, the prime real estate at the end of an aisle where research shows customers are more likely to notice products.

27. In the same way we work with brick-and-mortar stores, we also work with our digital partners to ensure that our artists are featured prominently on their services. Whether a digital customer visits the iTunes Store, or Amazon, or Spotify or Beats – we work to ensure that our artists and their music is prominently featured on the home page or included in curated playlists. More than ever before, our marketing and sales departments are focused on developing playlists of our own to feature on these services, and encouraging tastemakers to feature our music on their playlists. We encourage our artists to create playlists. Often, in our deals with interactive services, our partners offer marketing considerations, [redacted]

28. These marketing efforts can mean the difference between success and failure for a new artist. But they can also mean the difference between success and failure for an artist that has already developed a significant fan base. Just because an artist's first album was successful, that does not mean the second album will be. Sometimes it is more difficult to achieve success with a second effort when the first album was successful. For example, when an artist comes out with a new sound in their first album, by the time that their sophomore effort is released, that new sound may have been mimicked by others and is no longer as fresh and unique as the first time around. Often, bands have worked for years to craft the music they include on their first album, while the follow up has not had as much time to develop. Every album essentially requires a new marketing plan to ensure that it rises above the din and does not get lost in the millions of tracks available from us and our competitor for purchase or to stream through one of our digital partners.

29. Robin Thicke is a good example of an artist that has been signed with our labels for many years before he found true superstar level success. Thicke signed with Interscope

Records when he was 16 years old. Interscope spent years with Thicke helping him make records, tour and work with other artists. Although he had achieved some success with previous albums, he did not reach the number one slot on the U.S. pop charts until the summer of 2013 when "Blurred Lines," a track off of Thicke's sixth studio album of the same name, became a tremendous worldwide hit.

30. All of these efforts cost money, time and effort. In fiscal year 2013, we spent [redacted] on gross marketing costs net of recoveries to third parties, as well as [redacted] on our marketing overhead for the various departments focused on this important work. It is very difficult to predict which artists will succeed and which will fail. We do our best to sign artists who we believe will find success, and then we do our best to make sure that our marketing departments support their efforts and position them to succeed.

E. Manufacturing and Distribution

31. The last step in the process involves the actual manufacturing of records, and the distribution of music to retailers and digital partners for delivery to consumers. In recent years, our manufacturing and distribution operations have changed. While UMG once owned its own pressing plants, today it conducts its physical manufacturing through various third-party pressing plants. Those manufacturing costs for physical records represent significant third-party costs, totaling [redacted] in fiscal year 2013 for only a subset of Universal labels (excluding EMI). This includes costs we advance for pressing and distribution deals.

32. We also have invested and continue to invest in developing methods of efficient digital distribution. Since commercially viable digital services first emerged in the early 2000s, we have invested in excess of [redacted] in IT infrastructure and operating costs and in professionals that today distribute the thousands of digital files we provide to hundreds of digital

service providers every year. Our digital supply chain has evolved over time and today is comprised of several interacting electronic database systems, many of which have been developed only within the past few years.

33. We have a division called Universal Mastering Studios, or UMS, that converts artists' master sound recordings (or "masters") into digital audio files. We have systems that maintain our content assets, including the artwork and digital audio files that will eventually comprise our digital releases. A separate database controls the scheduling of our digital releases. While digital releases are often simultaneous with physical releases, that is not always the case. Our digital scheduling system ensures that product is released at the appropriate time. We also have a global repertoire system that tracks all of the key data associated with each recording, a global pricing system that we can use to determine price, and a global rights system that defines how we are permitted to use the recording. We have two more systems that work together to finalize and prepare the product for delivery to our digital partners. One system maintains our partner profiles and determines which content goes to which partner. And another system serves as our encoding engine, which ensures that each partner receives the artwork and digital audio files that meet their individual specifications.

34. Trained professionals are necessary to ensure that all of these systems work and that our digital releases reach the public smoothly. Before a digital release, a group within our Digital Supply Chain department is charged with reviewing the metadata that is supplied with the digital audio file to ensure that it is accurate, contains the correct categories of information, and is generally suitable for public dissemination. We also must ensure that the accompanying metadata that reflects the artwork, artist information, track information, etc., so that the service

can properly identify the recording in its system. People also need to handle the quality control and the administrative support required to make sure that these operations run smoothly.

IV. The Changing Music Business and its Effect on Our Decisions to Sign Artists

35. Over the last decade, the market for music has changed tremendously. Since 1999 and the emergence of Napster, music sales in the United States have declined over 50%. As a result, our revenues also have declined dramatically. This decline only increases the pressure on us to manage our costs and our losses wisely. In a market with declining sales, making the right calls and the right investments in the right artists is more important than ever. Signing an artist today involves even more of a commitment to invest significant money and time, and an even greater risk without any guarantee of a return.

36. The complexity of today's music market further complicates the risk that we face when deciding to sign a new artist. Today, music lovers consume music differently than they have ever before. Services that offer music "access" as opposed to traditional models of "ownership" are more popular today than they have ever been. As a result, our industry has shifted from a model that was focused primarily on selling records, to one in which every revenue stream matters. In order to defray our significant costs and reduce our considerable risk, we must hope that an artist becomes a success across all of the available platforms – and not just through sales of records.

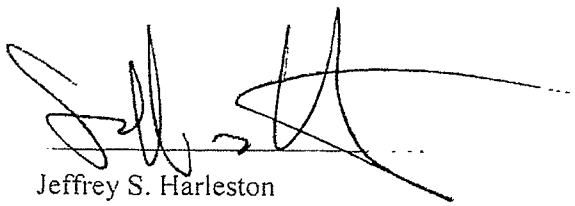
37. As but one example, consider Eminem – by any measure one of our company's true superstars. In May of 2000, Eminem released his second album, the Marshall Mathers LP. That record was a huge success, selling over 10 million copies in the United States. In May of 2013, Eminem released a follow up as his seventh studio album: the Marshall Mathers LP 2. That album was also a huge success when compared to other albums released at that time.

However, it sold only a fraction of what the first Marshall Mathers album sold – i.e., Marshall Mathers LP 2 sold approximately 2 million copies in the United States versus approximately 10 million copies for the first Marshall Mathers LP album. While the Marshall Mathers LP 2 has had several chart-topping singles, music fans simply do not purchase music at the level that they once did. That is not because they are not listening to the Marshall Mathers LP 2. To the contrary, Spotify this year named Eminem the most streamed artist of all time – based significantly on the over one hundred million streams for hits like "The Monster" off of Marshall Mathers LP 2.

38. Turning a new artist into the next breakout star is the product of hard work, significant investment, industry expertise, and considerable risk. We are in business to make money, of course, but we are in *this* business because we love music. We find the artists, help them record their music, and then market and distribute that music to music consumers everywhere. And, when the music is not commercially successful, we are the ones that bear the financial risk. Our digital partners get the benefit of our efforts as the creative input of their business is our artists' sound recordings. By contrast, our digital partners do not have to live, as we do, with the risk of failure despite our substantial efforts to bring a new artist's music to the public.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: October 6, 2014



Jeffrey S. Harleston

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

TESTIMONY OF

SIMON WHEELER

Director of Digital, Beggars Group

PUBLIC VERSION

Witness for SoundExchange, Inc.

Background

1. My name is Simon Wheeler, and I have been an employee of the Beggars Group, one of the largest collections of independent record labels in the world, since 1990. For most of my 24 years with the company, I have been involved in leading our efforts to license and distribute the sound recordings of our artists. In fact, I started working with the online distribution of sound recordings in 1997, and negotiated the first ever deal for the sale of territorially restricted digital downloads of the entire group's catalogue in 1998. I have been the Director of Digital and board member at Beggars Group since about 2007. In that capacity, I lead our negotiations and licensing efforts with digital music services, and help keep our labels at the forefront of all new technologies.

2. In addition to my position at Beggars Group, I am the Chairman of the New Media Committee of the Association of Independent Music or AIM, a UK-based non-profit trade organization that represents over 850 independent record companies. I have also spoken to the Parliament in the UK and testified to the Copyright Royalty Board to represent the views of independent record companies. Since 2009, I have served as a Board Member of VPL, a UK-based company that deals with the licensing and distribution of royalty fees associated with music video played in public or on broadcast television in the UK. My career is, has been, and always will be about music. Besides my extensive work in the negotiation of licenses and agreements with digital music services, I have been a musician, re-mixer, studio engineer, producer and concert promoter.

3. I submit this testimony based on my quarter century of experience working in the market for the licensing of sound recordings on behalf of independent record labels and artists.

The Beggars Group and Digital Licensing

4. The Beggars Group was born out of the Beggars Banquet record shops in London in the 1970s, with the first release of the original label in 1977. Nearly forty years later, the Beggars Group is one of the leading record companies in the world, and owns all or part of the iconic record labels 4AD, Matador, Rough Trade, and XL Recordings, and distributes the sound recordings of other labels like Young Turks.

5. Since our creation, our labels have always been focused on the discovery and development of outstanding artists. We have been fortunate in this regard, and have had the opportunity to work with amazing and diverse creators including Adele, The Alabama Shakes, Arcade Fire, Beck, The Cult, Grimes, The Libertines, M.I.A., Interpol, The National, Pavement, Pixies, The Prodigy, Queens of the Stone Age, Radiohead, Lou Reed, The Strokes, TV On The Radio, Vampire Weekend, The White Stripes, The xx, and Yo La Tengo, among countless others.

6. The impact of our artists is incredible and undeniable. For instance, Adele created both of her albums *19* and *21* as an XL recording artist, and the latter album is the most successful album globally this millennium. While the *21* album was distributed in the United States by Columbia Records under license from XL Recordings, Beggars Group also had the unique accomplishment of having the 2010 release *Contra*, by our artist Vampire Weekend, become the first Number One album in the United States by a UK independent label for a quarter of a century. And, we did it twice more in 2013 with an album by Queens of the Stone Age and another Vampire Weekend album. Our artists and their releases have also earned exceptional critical acclaim, including nominations and wins at the Grammys (last year's Best Alternative Music Album, *Modern Vampires of the City* by Vampire Weekend), more than 10 wins at the

Brit Awards, and the Mercury Prize – an annual music prize awarded for the best album from the United Kingdom and Ireland – four different times (The xx, Anthony and the Johnsons, Dizzee Rascal, Badly Drawn Boy). It would be a severe understatement to say that our artists cannot be overlooked when considering what consumers are listening to in the United States and worldwide.

7. Because of the pride we have in our artists, we make every effort to have their music heard widely and have their creative endeavors compensated fairly. In particular, we have been a leader when it comes to digital distribution and licensing of new music services, with some of our first distribution deals dating back to 1998. Generally speaking, and unlike many independent record companies, we handle our own digital licensing and distribution negotiations. In fact, I believe we have never used an aggregator or other digital distributor to negotiate a license for audio streaming in the United States with a digital music service. While there are instances in which one of our labels decides our artists will be better serviced by licensing the distribution rights to a particular release in a particular territory to a different distributor – as XL did with Adele's *21* in the United States – that is generally the exception, not the rule. In fact, even though we are both supportive of and quite active in MERLIN, a global rights agency who represents the rights of many independent companies, we have only opted into a handful of the deals they have negotiated.

8. That is not a reflection of MERLIN's efforts, which are quite strong, but rather our deep experience in directly negotiating with digital music services. We were one of the first record companies, independent or otherwise, to engage digital music services in negotiations for distribution and licensing agreements. We continue to be one of the most active. I estimate that Beggars Group has [redacted] deals worldwide with digital services, including

downloads, streaming, and other forms of distribution, and [redacted] include rights to audio streaming, though not always in the United States.

9. Because we were engaging digital music services in negotiations before most anyone else had started, we had to establish our own systems to manage our own rights. And we did. While this required significant investments on our part, this early and continued ability to negotiate directly with digital partners has afforded us certain benefits. First, we are able to have direct dialogues with digital services, which allows us to deepen the conversation and partnership over our repertoire enabling global campaign planning with services, which is not possible when working via a network of distributors, such as we did with the latest Queens Of The Stone Age album with Spotify, re-skinning the client application in multiple countries over the release period, messaging listeners in each territory and running a co-ordinated series of adverts in multiple languages. This type of campaign would have been almost impossible to achieve without the direct communication with the service. This direct dialogue also often allows us to address artist relations issues, which is really everything and more for Beggars Group labels, all of whom pride themselves on being artist-friendly and artist-forward companies. More concretely, by managing our own rights, Beggars Group has gained certain financial benefits by avoiding fees we would likely otherwise pay to distributors, which can range in the marketplace from 10-30% of wholesale revenues, depending on the clout of the label seeking distribution.

Resources Needed For Direct Licensing and the Independent Record Community

10. Unfortunately, managing one's own rights is neither easy nor inexpensive. There are a number of resources one must obtain, and which we do at some cost to our operation. First, a record label needs personnel with expertise in negotiating digital rights. Because the lifeblood of digital music services is the sound recordings provided by record companies, digital music

services often have experienced swarms of negotiators whose only role at the company is to negotiate these deals that, over time, have become increasingly complicated and sophisticated. I am fortunate to have experience that dates back to the inception of the first digital distribution deals but certainly my level of expertise is a bit of a rarity, particularly among personnel at independent record companies.

11. Second, a record company needs significant technical infrastructure and systems to handle the ever increasing flood of data coming back from the digital marketplace. Every service has their own different set of data points and even though we endeavor to try and impose some kind of standardization this is not always possible, so every month we receive reports from all of our partners which vary massively but can run to millions of lines of data and comprise hundreds of millions of transactions. The days of being able to process this flood of data via desktop software built for the physical age have long gone. We anticipated that we will need to increase our capacity for ingesting and processing data by a factor of ten over this year alone. Alongside this financial data is the need for more visibility and intelligence on our music performance in the marketplace so we take daily feeds from those companies able to supply it. These raw data feeds dwarf the monthly financial aggregated reports, but this is not only expected by our labels, managers and artists, it is demanded and has set new demands on us, not only financially, but technically. Within the Beggars Group, we run a variety of tools, some are bespoke builds for our requirements, some are new analytics tools off the shelf such as Tableau and there is a need to be aware of new developments that can provide more capacity and efficiency in this area.

12. Third, a record company needs technical resources to operate on a professional basis and license as widely as possible. There is sometimes the phrase "DIY" thrown around as

if digital distribution from the record company side is simply a matter of flipping a switch or clicking a button to transfer a file. This is not the case. When done professionally, being able to deliver sound recordings and the accompanying metadata to a wide array of digital service providers – many of whom have exacting metadata, technical, and delivery requirements – is no small feat. In fact, in 2003, to enable our own direct licensing and that of other independent record companies, we helped found Consolidated Independent ("CI"), which is now the leading provider of digital supply chain services to the world's premier independent music companies. CI provides encoding, warehousing, and digital delivery services to over 5,000 labels and delivers content to more than 250 online and mobile distribution services. These service do not come for free, and can cost an independent record label [redacted] depending on the volume of a label's catalog and number of digital services the label wants its sound recordings delivered to. While this is no insignificant cost, it is unavoidable if a label wants to manage its own rights, as the only other viable alternative is to bear all the costs of digital supply chain services which is uneconomic without a certain level of scale. Otherwise, the label will have no choice but to use a distributor who, as I mentioned, can take a substantial proportion of the label and artist's revenue in the form of a distribution fee.

13. Fourth, and perhaps most important, managing one's own rights is in large part about the size and strength of the music. We at Beggars are fortunate to have such a sizeable and strong roster of artists and catalog of repertoire. We also have the benefit of being one of the more well-established independent record companies, as the independent record company community is often the den of the most entrepreneurial music enthusiasts, and it is not uncommon to hear that an indie company is run out of a dorm room or the bedroom of a flat. Point being, most independent record companies lack the scale of roster to attract or even to

allow direct negotiations with many digital music services. You can have all the negotiators, data processing capacity, and digital supply services in the world, but if your digital music service partner will not engage someone of your scale – even if you have fantastic repertoire and outstanding artists, it becomes impossible to manage your own rights.

14. Unfortunately, the reality is that many independent record companies lack some or all of these necessary resources. Because of our tenure and our exceptional investments, Beggars Group is the exception to this situation, however, we acknowledge that the industry would be on more solid footing if more independent record companies were treated with appropriate respect in digital service negotiations.

15. This is one of the reasons we are quite supportive of collective negotiating efforts for the independent record company community – including those of MERLIN and trade bodies such as A2IM in the United States and AIM in the UK – even though we are able to manage our own rights and opt in to only a handful of the collectively negotiated deals. This is also one of the reasons it is especially important that compulsory regimes, where available, are set at strong rates consistent with the rates offered to market participants who are not constrained in negotiations by conditions unrelated to the product they are offering. None of the resources associated with direct licensing I discussed above have anything specific to do with the quality of or consumer demand for the sound recording; they are simply commercial conditions related to the structure of the record company. Without a strong compulsory rate that provides a suitable compensation alternative for record companies, independent record companies may often be forced to sacrifice value that the market would otherwise offer for their sound recordings, merely because they are small or new businesses, and not because their sound recordings are any less valuable. That is, if they are even allowed at the negotiating table in the first place.

16. While this commercial and negotiating asymmetry – where independent record companies are often treated in direct negotiations as if their repertoire is not as important or of equivalent value as others – is widespread, I do think that position is both incorrect and short-sighted. Regardless of the size of the rights-holder, having the strength of independent artist repertoire is important for the credibility of new music services with the consumer audience. In my experience, services that are willing to launch without significant independent repertoire are, generally speaking, less commercially successful, if they are commercially viable in the long-run at all. MySpace is one of the more high profile examples where their re-launch specifically excluded many important independent labels as they believed that our repertoire was not as valuable as that owned by the larger labels, so it was not possible for us or MERLIN to achieve acceptable commercial terms. It would be fair to say that their re-launch has not been successful; other examples are, by definition, unlikely to be household names. That is because, at the end of the day, songs speak for themselves, and independently-owned songs speak to many consumers who value the sound recordings for the quality of the artist's craft, not the size of the record company's market share.

17. One area where the commercial asymmetry of license negotiations is particularly difficult for independent record companies is with digital services that allow (and sometimes emphasize) user-generated content. The entire nature of the discussion we have with such services is entirely different because we do not have a strong control over what is posted, do not have the resources to monitor what is posted with regularity, and do not have the extraordinary resources to engage in an ongoing notice-and-takedown exercise with digital music services. While I doubt this is an enterprise that any record company really wants to expend its resources on, independent record companies tend to spend the lion's share of their resources on supporting

their artists in the production of excellent sound recordings and marketing those recordings, so tend to have little to no resources to facilitate gamesmanship of legal maneuvering and compliance with issues created by user-generated content. The best we can do is expend our very limited resources on identifying what must be taken down for artist relations issues. This is no secret, including to such services. As a consequence, negotiations with them can sometimes resemble the often quoted "whack-a-mole" proposition – only we are the moles: Either we submit to the club of the terms offered or be hidden by the service (sometimes with threats of blocking or muting our official content), all the while users will continue to post our sound recordings without compensation to us or our artists. In scenarios like these where the service's design is to allow use of our product by users even where we are unwilling, the negotiation does not approximate to me what we would otherwise negotiate in the market.

The Market Value of Independent Record Company Sound Recordings

18. There is sometimes a perception among services or elsewhere that the value of the rights offered by independent record companies is somehow diluted or less than the value of sound recordings from other record companies, or that we care less about the value of our repertoire. That has not been my experience. Our rights are just as important, as are our artists, we are entitled to A-list prices for A-list repertoire. At Beggars Group, we are just as capable of understanding the complexity of the rights and licenses at issue and we are careful to license specific rights at specific rates.

19. For instance, my general sense of the market for the use of our repertoire on a service that includes on-demand functionality is that we would start negotiating from some form of a greater-of rate structure framework that looks something like what follows: First, Beggars Group would receive its pro-rata share of roughly [redacted] of the service's revenue. This

reflects the general sentiments that not only should we share in the revenue of a service but that a service that is built on the distribution of our content should pay a bit more than the majority of their revenue to us, particularly, in light of the general industry precedent of providing approximately 70% of retail revenue as the wholesale price for digital content, especially digital music content.

20. Second, where a service utilizes a subscription model, we would insist on our pro-rata share of a per-subscriber minimum to ensure roughly equivalent value, particularly where the service was attempting to experiment with different monetization or market share strategies to grow their audience.

21. Third, we would insist on some form of usage-based metric to ensure that the value of our sound recordings is not being diluted in the overall marketplace because of the design and operation choices of a service. Generally, that usage-rate would range from [redacted] for fully functional on-demand plays.

22. Fourth, in many instances, we would (and do) [redacted] from the service to protect the risk we bear of a service using our music but failing due to its own business choices, its own lack of focus on monetization, or the circumstances of the market.

23. Finally, we are increasingly requiring [redacted], as I worry that other, larger players in the market will be able to negotiate around the competition for consumer consumption.

24. This understanding is not just hypothetical. It reflects my real experience in actual negotiations.

The Music Industry Is Shifting From a Purchasing Business to a Consumption Business

25. We are currently experiencing the most important change in the recorded music business since the shift to recording music itself. Increasingly, and increasingly faster than anyone expected, we are no longer *selling* music and consumers are no longer *purchasing* music. In past format changes since the advent of recorded music, we were still selling the record, albeit in a different format, whether that be cassettes, vinyl, compact discs, or digital downloads. This shift is different: now we are *licensing* music so that consumers can listen to, or rather, *consume* it.

26. We are no longer, generally or specifically, platform agnostic. When we were *selling* music, the format of the music, which we controlled, was imperative to pricing but the platform it was offered on was far less significant (except, of course, in the case of unauthorized offerings such as piracy which were not really sales to begin with). A sale of a CD was, generally speaking, a sale of a CD, whether it be in the independent record shops which birthed Beggars Banquet or the large commercial retailers. Similarly, a sale of a download, generally speaking, was the sale of a download. As we become a consumption business and consumers consume our product everywhere, anywhere, and on many different platforms, the format is less in our control because it is more integrated into the platform. And, the platform is more specific in its business model and use of our music. Some platforms for consumption – services like Spotify, for instance – are committed to business models that maintain the value of music by encouraging listening on a subscription basis. It is nothing less than imperative that we get paid

for our usage on those services and make sure not to dilute the market value of our usage by licensing consumption to other services at rates that denigrate subscription models.

27. At Beggars Group, we see this more readily than others because we are at the head of the curve in the industry's overall shift to a digital consumption business. Like independent music companies generally, our shift to a focus on digital consumption revenue has outpaced the industry. This is in part because significant parts of our repertoire – for example, independent rock or electronic dance music – tend to attract highly-engaged music consumers, many of whom are also early adopters of technology, including streaming services. Also, specific to Beggars Group, because we have licensed our music early and often in managing our own rights, our repertoire is generally widely available in the digital space.

28. The results are noticeable, and likely a good indication of where the rest of the industry is quickly headed. At Beggars Group, already [redacted]. Moreover, of our top ten digital service partners this year, [redacted] were audio streaming businesses. I estimate that by 2020, it is conceivable that [redacted] of our revenue will come from consumption-based streaming models, including those at issue in those proceedings. And, like the rest of the industry, it seems that my predictions about the shift to consumption are often more restrained than the faster and starker shifts that occur in the market.

29. Thus, consumption-based streaming revenue, including webcasting royalty revenue, is already core revenue in our business model, and that will only increasingly be the case. Yet, core revenue needs to be able to support the core costs of a business. As the revenue

mix of record companies shifts towards what I am seeing today in the Beggars Group and webcasting revenue becomes more and more a larger portion at the center of our revenue outlook, it is simply the case that we would license it at rates that anticipate the fact that it will be a center of our business, and therefore have to support the costs associated with our business model.

Customized Webcasting Threatens to Substitute For Subscription-Based Models

30. As I said before, we cannot afford to be platform agnostic in a consumption-based market. A revenue plan for a record company in this environment may depend in some part on offering their repertoire on a number of different platforms, but it must also depend on avoiding the dilution of value of music across platforms. We cannot afford nor should we allow certain services to gain a competitive advantage over other platforms that are more willing to offer a higher value per consumption. And, when services that compete for consumer consumption with lower revenues per-stream or per-user are offered rates below those of other competitors, we are subsidizing our own demise.

31. I am troubled at the increasing customization and sophistication of webcasting services, often still billing themselves as "online radio." It seems that they are now attempting to offer enough of a complete music experience, whether it be through their highly touted customization, personalization, or aggregation of a consumer's listening data, to draw consumers away from the higher-revenue-per-consumption services, such as on-demand subscription services. We seem to be reaching a saturation point for most consumers with the functionality provided by these webcasting experiences; if we are not already there, I worry that we will get there within the next couple of years.

32. From what I know, this is particularly so in the United States where consumers seem more willing to accept "lean-back" music experiences instead of adopting the on-demand models that are more prevalent in Europe. For example, in analyzing usage data, I have observed that consumers in the United States have roughly [redacted]. This makes me think that there is more of a passive user experience in the United States, listening to sets of playlists on a constant consumption basis rather than a search and play experience. Also, in my discussions with others in the industry, I often hear reference to how there is more of a "lean back" mentality in the United States. Most on-demand services have launched "radio" products within their service to cater to this behavior.

33. Online webcasters seem to be pushing the edges with their customization as well. Every online radio or webcasting service seems to be coming out with their own twist of personalization or customization. A recent trend has been mood based, or activity based, curation by companies such as Songza. The algorithms and other forms of curation utilized by webcasters seem to be getting smarter, both in terms of sophistication and the amount of data they contain. It makes me wonder how different it is for a consumer to pick a particular sound recording in an instant moment or to know that the next song is going to be selected by five years of that same consumer's thumbs up or downs decisions on a station they created, seeded, and added variety to over the same period. It is not clear to me which really is the more user-influenced choice. I worry that in the last few years, these trends in webcasting seem to push the statutory requirements with respect to the consumer-facing consumption experience that webcasters are providing, particularly when balanced against the relatively lower per-play or per-user revenue they are paying to record companies like my own.

34. To be clear, this is no longer a question of ancillary revenue for Beggars Group and for the industry as a whole. From where I stand, when we address consumption-based webcasting, and its obvious relationship to consumption-based on-demand streaming models generally, we are talking about the core of the music business. And, when we address the rates for webcasting services, and their obvious relationship to the rates for directly-licensed on-demand streaming services, we are addressing core revenue streams of the recorded music business.

35. Consequently, I believe and would expect that webcasting, particularly going forward, must be licensed at rates that closely approximate the rates of on-demand streaming services. There is a real danger that webcasting services provide *enough* functionality such that most consumers will not need to or will choose not to look to on-demand subscription services. Put another way, the increasing sophistication of webcasting seems to be shrinking the difference that on-demand functionality makes to consumers.

36. This is not to say that the two consumption-based experiences are exactly the same, but only that the distinction between them is less and less a meaningful difference for consumers when I consider how they use and appreciate our repertoire. Many people do not understand the difference between say, Pandora and Spotify, they are just listening to music. With this in mind, I would expect that a negotiating framework for webcasting would largely approximate the on-demand service framework I identified above.

37. With respect to revenue sharing, there may still be some fluidity between the two types of services, but I am not sure there should be any difference between the revenue sharing rates of a webcasting service and the revenue sharing rates for on-demand services. Revenue sharing is really a reflection of the relationship between a rights holder and a service that builds

its business on the content we provide. In both instances, webcasters and on-demand models are offering one product – our sound recordings – to attract users. Also, from my vantage point, all consumption-based business models are still in the experimentation stage and relatively undeveloped, whether they be ad-supported or subscriber-based. It is not yet clear if there will be a definitive specific business model – or even a specific service – that will dominate the next era of music consumption. So, in my view, record companies cannot afford to share in revenue on only one side of the market, and risk that the other business model in the market prevails in the eyes of consumers.

38. That said, in the present state of the market, I remain skeptical of the immediate ability or desire of many online ad-supported webcasters to generate revenue, much less share it record companies. It seems to me that many are still trying to attract a critical mass of users by providing to them as much music as they can. So, for me, a strong usage-based metric, particularly a strong per-play rate is crucial, both to allow the webcasters to experiment with our music but not at our peril and to make sure that in so doing, they are not diluting the value of our repertoire. I know that the current rates paid by statutory webcasters in the US are roughly around a quarter of a cent per performance. Based on where I see the per-performance rates when negotiating licenses for on-demand streaming services, that feels about right to me for today because statutory webcasting does offer slightly less functionality (i.e. no on-demand) but there is not really much other difference.

39. Furthermore, that is my sense today, not tomorrow. Given what I have said above about the rapid shift in the industry, it is quite important that the statutory webcasting rate continue to escalate over time, particularly because unlike direct negotiations, I have no ability to revisit the situation in a year or two if the market shifts outside our expectations. Also, as

discussed above, there is a need for an escalating rate because increasingly, webcasting revenue will represent core revenue to our business and therefore have to support the core costs of our business as other streams of revenue decline.

40. In sum, consumption-based services, including both webcasting and on-demand services, are at the center of the access model to the recorded music industry, where the way we monetize sound recordings is through listening or consumption, as well as sales. At Beggars Group, we are already seeing that model take hold and only expect that trend to continue. Thus, because webcasting and on-demand services compete for consumption, we face an important challenge in our licensing landscape. Furthermore, as the webcasting services are becoming more sophisticated in the use of user-based data, it appears that there is only so much space between them and on-demand services and that space is shrinking. When I negotiate licenses in this context, I am increasingly aware that in a consumption-based model, we must be careful of the relationship between these two types of consumption-based services. This is not to say that I deny the importance of webcasting services – quite the opposite. As webcasting services have become more prevalent and predominate, I know that Beggars Group and the market more generally would and should treat them as core business revenue that has an important effect on the other services at the center of our changing recorded music business.

Promotion is Simply Different in a Consumption Business

41. One of the important changes as the industry shifts to a consumption based model is how we think about promotion. It used to be the case that record companies, including Beggars Group, was ultimately selling a particular and tangible product – a CD, for instance. And, the way we could sell this end product was merely by spreading awareness through limited consumption of the music itself, such as streaming the music or getting it played on the radio.

42. After this paradigm shift, what it means to be promotional will change. Promotion is remarkably different when the end product of recorded music is consumption of our music itself. No longer are free or low-value streams something we can just give away unless they are directly connected to enticing users to a higher-value method of consumption, such as a music subscription. While I recognize that it is always somewhat useful for consumers learn about our artists and their music, the value of general awareness is lessened significantly when the way we create it is by diluting the value of our end product – a stream of our sound recordings – in the process. And, it is my sense that streaming music on one service, such as a webcaster, will not induce a consumer to buy a premium subscription on another service, such as an on-demand service. Indeed, it is the incentive of the webcaster to do the exact opposite and encourage consumers not to switch.

Substantial Compulsory License Rates Are Important to Independent Record Companies

43. For an independent record company like Beggars Group that engages in a lot of direct negotiations for the licensing of sound recordings, it is imperative that the rates provided for in the compulsory license are substantial and in line with the existing market rates for other music streaming services. It is simply unavoidable that the compulsory license in a territory will create a reference point in direct negotiations, particularly because services operating under compulsory licenses do and will continue to compete with the services we license through direct negotiations.

44. Generally speaking, when a service operates under a compulsory license, it sets a rate ceiling around my negotiations for a direct license with that service, and it becomes very difficult to negotiate for a rate higher than the compulsory license rate. The digital service is aware that my company has no recourse if the service elects to use the rates and terms of the

compulsory license, no matter how large or small the service is. If the rates were set too low, particularly for a service that occupies a large portion of the consumption in a particularly territory, the only possible option my company would be to altogether stop the commercial distribution of our sound recordings in that territory. And, that is to say, we really have no option at all, as we want the public to hear the recordings our artists create.

45. Also, a strong compulsory rate is important to independent record companies like mine because services operating under a blanket compulsory license have every incentive to treat all sound recordings equally – including independently-owned sound recordings. This repertoire parity lets music stand on its own merits, which is important and offers a lot of comfort to the independent record community at large. We believe strongly in our artists and want them to have a chance to be heard at a compensation that is on par with other creators.

46. Beggars Group, like most other independent record companies, puts our artists and the music they create first. We are music fans and enthusiasts and as such, we are enthusiastic about the recordings of our artists and others. We support them in every way we can. While much of my testimony has centered on the considerable efforts we make to manage the rights of our repertoire, that is neither the beginning nor end of our efforts to support our artists. Our labels spend considerable time and effort to find new quality artists, including finding voices in areas that the existing market has not yet embraced. Once discovered, we maintain a staff that supports and assists our artists develop professionally and creatively. We work with these artists to provide them a creative and professional home so that they can record and produce recordings of the highest quality. We distribute these recordings in many territories, helping our artists navigate the complexities, rules, and regulations unique to each territory. We market artists to bring their work to a broad audience in a very competitive world and help to

realize their creativity to its fullest potential. We do all of this on top of expending the substantial resources to negotiate, license, and deliver their music to digital services where consumers can listen to their recordings. And, of course, we are their advocates, doing all we can to ensure that they and we receive fair market consideration from the businesses that are built on the backs of their songs.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 6th October 2014

Simon Wheeler

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Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

TESTIMONY OF

DARIUS VAN ARMAN

Co-Founder and Co-Owner of Secretly Group

PUBLIC VERSION

Witness for SoundExchange, Inc.

Background and Qualifications

I am Darius Van Arman, co-founder and co-owner of Secretly Group, which consists of the four independent record labels Jagjaguwar, Dead Oceans, Secretly Canadian, and the Numero Group. Secretly Group is headquartered in Bloomington, Indiana and shares ownership with affiliated companies SC Distribution, Fort William Artist Management, and Secretly Canadian Publishing. Altogether, these companies employ about seventy U.S. employees.

In addition to my position with Secretly Group, I am also actively involved in the independent record label community. I am currently a non-voting observer on the Board of the Music and Entertainment Rights Licensing Independent Network or "MERLIN," a global rights agency for the independent label sector. I am also a founding and current member of the Worldwide Independent Network (or "WIN") Council, an international group of independent label owners brought together in 2013 to help advise WIN. WIN is the global representative organization founded in July 2006 to represent independent music companies and their national trade organizations. Previously, I served on the Board of Directors of the American Association of Independent Music ("A2IM"), a not-for-profit trade organization representing over 330 independently owned music labels in the United States. I am also a member of the Board of Directors of SoundExchange, Inc.

I have testified before the Copyright Royalty Judges to present the views of an independent record label in a proceeding concerning royalties payable by SIRIUS XM for its satellite radio service and certain services that stream sound recordings over satellite and cable television. I have also recently testified before the Subcommittee on Courts, Intellectual Property, and the Internet of the House Judiciary Committee to reflect my own views and the perspective of the independent community. I understand that the purpose of this proceeding is to

set the rates and terms of the compulsory license for digital sound recordings in the United States available to non-interactive services (which I will refer to generally as "webcasters") for the years 2016-2020. While I am testifying based on my own experience and that of Secretly Group, I am also testifying to offer the Judges the perspective of the independent record company community in the United States.

Independent Record Companies and the Digital Music Landscape

The independent record company community is a vibrant and vital part of the American music landscape. When I founded the record label Jagjaguwar out of my bedroom in Charlottesville, Virginia, in 1996, I hardly imagined that the labels I would become a part of would one day be the home of such prominent artists as Bon Iver, a recording artist who won the Grammy Awards for both Best New Artist and Best Alternative Album, or Tig Notaro, a 2014 Grammy nominee for Best Comedy Album. Our labels have rich and diverse rosters totaling over sixty active artists, including emerging, contemporary acts such as singer-songwriter Sharon Van Etten, electronic music project Major Lazer, and the critically acclaimed rock group The War on Drugs, as well as iconic acts like Dinosaur Jr., a band that has been releasing important records to the American public since 1984. In addition to supporting these important artists, Secretly Group helps new generations of music consumers discover classic musical gems through the efforts of the Numero Group, an archival label that creates compilations of previously released music from a variety of genres. Secretly Group releases have become gold singles and albums and have received critical recognition, including multiple Grammy nominations. More importantly, our efforts and the efforts of the artists we work with have made vital contributions to the overall music landscape in the United States.

In this way, our experience is emblematic of independent music companies in general. Independent labels release some of the most prominent and commercially successful records, including those by artists like Paul McCartney, Adele, Macklemore, Taylor Swift, and the Lumineers. In fact, according to Nielsen Soundscan figures for calendar 2013, independently-owned repertoire constituted 34.6% of the market for music sales. Independent record labels not only have a significant commercial share of the market, we also often support the release of sound recordings that would otherwise never be heard, either because the artists are undiscovered or the sound recordings appeal to devoted but niche audiences. We are proud of the quality of our artists and the music they create. And others recognize the value of these sound recordings as well. In fact, this year, independent labels and artists led the industry once again at the Grammy Awards, winning half of this year's awards and claiming half of this year's non-producer nominations. To put it mildly, the contributions of independent record companies and artists are at the center of music in the United States.

Independent Record Companies and Revenue From Digital Music

To ensure that the public is able to receive the benefit of the wonderful sound recordings of our artists, independent record companies must act as would any responsible small business. Our margin of error is much slimmer than other much larger record companies or digital music services who are often backed by significant investors and capital. We have no external source of funding so, generally speaking, we cannot afford to release albums that lose money for us.

At Secretly Group, and at independent record companies generally, we invest a lot of time and effort into each of our artists and their releases. We spend a great deal of time and effort seeking out recording artists that we believe in to sign to our rosters. We listen to a large number of the demos submitted to us by artists looking to work with one of our companies. We attend

showcases, shows, and music festivals around the country, we read music websites and magazines, and we receive referrals from other artists, labels, managers and booking agents. We spend considerable time identifying artists we want to work with (based on music merits) but we also talk with them and their representatives to make sure we are compatible both philosophically and with regards to business-related expectations. We freely offer business advice to prospective artists and connect them to others that can help them in ways that we cannot. And, for those artists who ultimately sign to our labels, we spend significant resources promoting their music and career.

Our business model at Secretly Group is straightforward: break even or generate a profit on the majority of our releases. Because we have hit that goal, we remain profitable. While much of the independent record community shares that goal, not everyone is as fortunate as we are, and I often see independent labels shutter.

The reality is that this is a very difficult environment for independent record labels. Sales of physical CDs have been in steady decline for several years, and, more recently, we have seen a decline in the sales of digital downloads. Yet the costs of our efforts and resources in supporting our artists remain as high as ever. So we face declining sales revenues and if we rush to release more records, we will simply dilute our efforts, alienate our artists, and fail to operate within the general model on which the independent record label business is built on – consistent success across the majority of releases.

This challenge is compounded by the reliance of independent record companies on digital revenues. While there are exceptions, more established artists usually release records that have a higher percentage of sales through physical products. Younger, less established artists will, by contrast, tend to release records that earn more through digital products. And, broadly speaking,

independent record companies tend to attract more of the younger, less established artists. Consequently, independent labels experience the overall shift to digital revenues more quickly than the remainder of the industry. For example, in just the past five years, the digital revenues of the Secretly Group labels Jagjaguwar, Dead Oceans, and Secretly Canadian, when combined, have more than tripled, and they have grown from approximately fifty (50) percent of our total distribution revenues to approximately sixty five (65) percent of our total distribution revenues.

Because of these and other challenges, every digital stream of revenue – including webcasting royalties – is crucial to our revenue outlook. No one digital stream of revenue could sustain our business by itself at this moment and the pressure on statutory streaming royalties is heightened by the noticeable decline in digital sales. I estimate that digital audio streaming revenues (noninteractive and interactive, combined) will exceed digital sales revenues for our labels within the next five years. If there is not a strong royalty rate for statutory webcasting or if that royalty rate drags down rates in other streaming models, I am afraid that we will not be able to break even on most of our releases. In that case, we may sign fewer artists, support fewer album releases or take even more drastic business measures. Needless to say, I regard a strong compulsory license rate as crucial to our business future and the future of independent record companies overall.

Independent Record Companies and Licensing of Digital Sound Recordings

Just as independent record companies come in a variety of shapes and sizes, they also license their sound recordings to digital music services in a number of different ways.

Digital Licensing via Major Record Companies. Most prominently, many independent record companies distribute their recordings through the distribution services of the three major record companies – Sony, Universal, and Warner. For instance, according to the Nielsen

numbers I referenced above and solely on the basis of copyright *ownership*, 34.6% of the market share of sales of sound recordings is *owned* by independent record companies. However, many independent record companies will distribute their sound recordings through major record companies. While I cannot say for certain how large that percentage is, I do know that a substantial portion of independently-owned sound recordings are digitally distributed by one of the three majors.

When an independent record company uses the digital distribution services of a major record company, it is my understanding that generally it is the terms of the major's license with a digital music service that govern the rates and terms for distribution of those sound recordings. I am aware of exceptional circumstances – including my own past experience – where an independent record company uses a major record company primarily for physical distribution and retains digital distribution rights, but again, that is the exception. For example, whereas Secretly Group is one of the larger and more prominent independent label groups in the marketplace, it was only just recently that the digital distribution of our releases became independent of any major record company. Previously, Secretly Group releases were digitally distributed in the United States by Warner, in connection to Warner's physical and digital distribution agreement with SC Distribution. This changed at the beginning of 2014, however, when SC Distribution, as part of Independent Distribution Cooperative (or "IDC", and which also includes as members such independent record companies as Beggars Group, Domino Records, Merge Records and Saddle Creek), entered into a new physical-only distribution agreement with Alternative Distribution Alliance (or "ADA"), the Warner distribution arm that focuses on independent repertoire. So only now is Secretly Group repertoire independently distributed to digital services.

There are probably a number of reasons that an independent record company may choose to handle its own digital distribution rights. Of course, one of those reasons is that doing so can save the independent record company from paying a distribution fee to the majors. This is no small concern because independent labels often aim to and depend on breaking at least even on the majority of their releases. A hefty distribution fee can make this difficult, especially as the market becomes more focused on digital sales and streams and less concerned with physical product.

Direct Digital Licensing. While less common, some independent record companies handle digital licensing negotiations on their own. This can be challenging from a resource perspective because almost all independent record companies are small or medium-sized businesses. They often lack the staffing resources to engage in direct license negotiations, particularly with the very large and sophisticated companies whose core business turns largely on the license terms they can extract for sound recordings. For instance, Secretly Group and its affiliated companies are one of the larger collections of independent record companies, and we employ about 70 people in the United States, but as I understand it, Pandora alone has over 1,400 employees. This is not just a challenge of quantity of resources, it is one of expertise. In fact, of our 70 employees, our full business affairs team is composed of only 4 people, including me. Only three of our employees have experience with digital licensing negotiations. It would not surprise me if at many independent record companies, the number of employees with licensing expertise is only one or none. This is especially challenging because the negotiators for these digital music services are repeat players who understand what other record companies have required to license sound recordings on the same service whereas we have to learn anew each digital music service and how it intends to make our music available to consumers.

All of these challenges, of course, assume we can even get to the negotiating table with the digital music service. Despite the important value of independent music, sometimes individual independent record companies lack the scale to get the attention of digital music services. If the first challenge of the negotiation is simply to have one, it makes it difficult for an individual independent record label to secure the same terms for their sound recordings as other labels. That is probably one of the reasons that many independent labels choose to distribute their sound recordings through major record companies, despite the distribution fees in the typical range of 10 to 20% that independent labels generally end up paying to majors for digital distribution.

Digital Licensing Through Independent Distributors or Collectives. Sometimes independent record companies attempt to overcome the inherent barriers of going it alone by banding together for digital licensing.

One way to do so is to work through an independent distributor like SC Distribution. SC Distribution was founded in 1997 to attempt to address this issue and provide collective clout to independent record companies. Over the last 15 years, SC Distribution has distributed music for over 50 labels, including the four Secretly Group labels. As mentioned above, whereas SC Distribution had until very recently relied on Warner's distribution arm ADA for digital distribution services (in connection with its previous physical and digital distribution agreement with ADA), this was only for the repertoire of the three labels Dead Oceans, Jagjaguwar and Secretly Canadian. For the other labels distributed by SC Distribution, digital distribution services were provided solely by SC Distribution, through its direct agreements with digital services. As such, through SC Distribution, I have seen what it is like to negotiate directly with digital music services.

Another way that independent record companies band together for digital negotiations is through MERLIN, a global rights agency that negotiates on behalf of the independent label sectors. MERLIN negotiates on behalf of over 20,000 independent label members in 39 countries. MERLIN offers digital services – including the negotiation of agreements to license digital sound recordings to digital music services – to its members, which include Secretly Group. Our collective hope is that by allowing MERLIN to negotiate on behalf of so much repertoire, it will improve the terms that an independent company could get negotiating on its own. The conventional wisdom is that when MERLIN is able to collectively represent many independents, then we are in a better negotiating position as independent companies than if we all tried to negotiate separate deals on our own. If MERLIN is able to reach an agreement with the service, MERLIN sends its members, including me, a Notice of Proposed Action describing the deal terms and giving each member label the opportunity to opt out of the deal. Each time Secretly Group receives such a notice, we consider the terms offered before deciding whether we should agree to those terms or opt out. In several cases, we have agreed to the terms of the MERLIN-negotiated deals.

Independent Record Companies and the Direct License Market

I am a strong proponent of the compulsory license for a number of reasons not the least of which is that it is our best hope of creating a level playing field among record companies. This is especially important because of trends I have observed in the direct licensing market.

Digital Breakage. The first trend is a shift to compensating record companies on the basis of unattributable income, which I have referred to when testifying before Congress as "breakage." The issue of "breakage" is that some record companies may be receiving compensation for their sound recordings that is not readily transparent to others in the

marketplace. This compensation, however, *is* part of the value a company receives for the use of sound recordings even when expressed as "breakage." The proper value of a license simply cannot be understood without including all compensation, including this "breakage" compensation. And, the overarching issue I have discussed elsewhere is that it can be difficult to negotiate in a market when one does not include all relevant consideration in understanding the marketplace.

Imagine that a digital service offers a licensing deal to a record company. There are a number of different ways in which the streaming service could offer important and valuable consideration to the record company, including a percentage of the service's revenue, a per-stream royalty rate, a minimum payment per subscriber, an advance payment at the beginning of the term, a guarantee on the back end, some form of profit participation (e.g. an equity stake) and so on and so forth. Each of these are mechanisms that compensate a rights holder in the marketplace for the use of a product — here, sound recordings. In the negotiation, both the record company and service could try to change the mix of the consideration (e.g. add an equity stake) or the amounts of particular pockets of the consideration (shift to a larger guarantee). In many instances, the other party, whether it be a record company or a service, can be indifferent to the proposal because, after all, consideration is consideration and what we are really discussing here is the method of payment, not the payment itself.

Of course, the method of payment can make a difference to those who are represented by the record company in the negotiations – e.g. artists or independent record labels distributed through a major. They are potentially at risk if the negotiating record company chooses not to attribute income from what I have called "breakage." And this is important because, in my view, breakage is valuable consideration that is included in a licensing deal as part of the total

compensation for a sound recording. To act otherwise would simply understate the value of the consideration received for the use of music.

There is another side to this "breakage" story. A licensing deal made between one record company and a service may well affect the deals that are offered to other record companies, especially independent record companies who are often approached after a service is well into negotiations with the majors. By pushing consideration in certain deals into less transparent mechanisms like equity stakes or advances that cannot possibly be recouped, a service may be able to push for a lower per-stream royalty rate with record company A. Then, when the service approaches record company B – often an independent company – the service can represent that company B is receiving no worse of a per-stream royalty rate than any of its other label partners.

While I do not know the terms of the major record company licenses with Apple for its iTunes Radio services, I suspect this is essentially what happened. Having already engaged the majors in negotiations, Apple put forward a "take-it-or-leave-it" license offer for iTunes Radio to independent labels, as an amendment to their existing iTunes agreements and in a manner utilizing an online click-through mechanism (i.e. an acknowledgement checkbox). Presented in such a way, in close proximity to the launch of the new iTunes Radio service and well after iTunes had concluded negotiations with the major record companies, there was no meaningful opportunity for independent companies to negotiate iTunes Radio terms with Apple. The license offer, which was published on an internet news site, included not only iTunes Radio but other Apple digital music services, including the iTunes Store. In other words, this was not just take-it-or-leave it on iTunes Radio, it was a take-it-or-leave-the download store offer. I highly suspect but do not know for sure that we were simply offered the same per-stream rates as the majors without any of the other breakage consideration they may have received.

Indeed, with respect to other digital services, I have even heard discussions of a "negative most-favored nations" clause wherein the record company Bs of the world – often, independent record companies – must agree to provide rate relief in a deal if another record company agrees to a lower per-stream royalty. Thus, digital breakage often creates a situation where a focus only on per-stream rate parity does not reflect the total value of the deal. That creates a dangerous situation in which some music is devalued solely because of the identity of the rights holder. But, music is music and a sound recording from an independent record company is no less valuable than a sound recording from another record company, major or otherwise. The commercial value of the recording should stand and fall on its ability to resonate with consumers. It should not be based according to who has acquired the biggest bucket of rights or who has established the most control over distribution pipelines to consumers.

Importantly, digital breakage revenues are not just earned by major record companies, they are also earned by independent record companies, including MERLIN, which maintains equity stakes in some of its digital service partners. SC Distribution has itself done deals where the compensation through unrecouped advances and guarantees is expected to yield digital breakage. While apportioning breakage pro-rata based on actual performance on the service, a policy MERLIN and others have adopted and that I support, can address the attribution question between distributors, independent labels, and artists — and which mitigates to a large extent the dangerous situation discussed above where commercial value is not based on actual usage by consumers — , there is the separate issue of how breakage affects the negotiations for direct licenses. The only way I can see to avoid the distorting effects of breakage is to understand and consider all revenue received by a record company under a direct licensing deal, including digital breakage.

Pro-Rata Terms. When I was last before this Board, I explained that I am opposed in principle to a system in which the decision of what recordings are played is not based on the quality of or consumer interest in the recordings, but rather on the deal terms of a direct license. Unfortunately, this has increasingly become the direct licensing world we live in, as services seem to be offering additional plays or promotion within the service to particular rights holders to increase the rights holder's pro-rata share of plays – what I call "play-share incentives" – in exchange for lower consideration or rate relief. Without a strong statutory rate that allows record companies, whether major or independent, to reject play-share incentives, I am afraid this will become an inevitability.

My concern is that the use of play-share incentives will devolve into a race to the bottom in which you de-value your music just to have your songs heard. Moreover, deals that include incentives related to number of plays or pro-rata share weaken the market as a whole because they cannot be universalized to all rights holders as a digital service cannot promise an increase in pro-rata *share* to everyone. If someone gets the play-share benefit of signing on first, then someone else will be in the unenviable position of finishing last. It worries me that independent record companies, who often have the least leverage in direct negotiations, may be left with an impossible choice: either run to the front of the line to offer rate relief in exchange for plays or worry that we will be left out of commercially determined playlists dominated by the majors. Just three years since my last testimony, it feels like we are now cascading down that slippery slope I described and the bottom of the hill is one where access to the online word requires us to further de-value our music to overcome real, non-meritocratic obstacles.

The Importance of a Strong Statutory License Rate

Given what I have described above, it has never been more important to the independent record community to have a strong statutory license, particularly with a strong royalty rate.

A strong statutory license creates a level playing field. When repertoire is given equal value through an equal royalty rate, services have no incentive but to allow sound recordings to compete for the attention of their users and, royalty rates being equal, feature the sound recordings that are most likely to increase users and listening. Consequently, the compulsory license is the best if not only hope for this equal playing field because it is agnostic to the market position of the rights owner when determining the royalty required for a song.

This equal playing field is also important for independent record companies because the statutory license eliminates transaction costs that would be daunting if not prohibitive in the direct licensing market. Put simply, many independent labels do not have the resources to engage in direct licensing with the many digital services and webcasters so these labels have no practical option but to rely on the statutory license. For them, the statutory license is not a floor or ceiling to further negotiation because there will be no further negotiation, so the value of their music reflected in the statutory license is the value of their music they must accept. Notably, where independent record companies do negotiate directly, the statutory license still functions as a ceiling. It is hard for independent record companies to negotiate above whatever statutory rate a service may elect because the statutory license is compulsory and we have no right of refusal.

Nevertheless, the strength of the statutory license is significant for independent record companies in direct licensing negotiations as well. Much of the direct licensing world is opaque, whether because of digital breakage or otherwise, and independents are often the least well-

positioned to determine the true market value of a license for a service. The statutory license, by contrast, is transparent.

The growing influence of programmed play rates on digital music services, whether interactive or not, is yet another important reason for a strong statutory license rate. For instance, I recently rejected an offer by a long-standing digital partner, [redacted], requesting royalty relief on a "blended rate" of a tier of service that combined "radio plays" with "interactive plays." The blended rate offer, which I have attached as an exhibit to my testimony, was at [redacted] cents per stream whereas the partner's existing deal with SC Distribution pays us a [redacted] per interactive stream. While I did not accept the offer, it was a good example to me of the increasing consumer offerings of tiers that include both non-interactive and interactive streams as well as the effect of non-interactive streams on the per-play rates of other interactive services. In other words, I expect that the compulsory rate adopted in this proceeding will, in turn, drag down and therefore interfere with the rates offered to independent record companies by digital music services that offer interactive streams as well.

Finally, a strong compulsory rate is important for independent record companies today because more than ever we rely upon statutory royalties. With both CD sales and digital download sales declining, it is apparent to everyone that the future of the recorded music industry is in streaming, whether it be non-interactive or interactive. And that future is coming quickly to independent record companies because our business model requires us to break even on more of our releases – a daunting challenge in a world of sales decline. Thus, the only way we can expect to break even enough to keep releasing the important recordings of our artists is to receive significant per-stream royalties under the level playing field of the compulsory license.

SoundExchange As the Sole Collective

I have said before and continue to believe that SoundExchange has earned the right to continue serving as the sole collective to collect and distribute statutory royalties for copyright owners and performers. The organization is governed by and represents a balance of the interests of record companies, both major and independent label alike, and performing artists. In my experience, this organizational structure ensures that the interests of all constituents are heard and represented. Also, SoundExchange is a non-profit organization, which ensures that it operates to maximize royalties for all recipients, and has a good track record of doing just that through its administration and advocacy efforts on behalf of copyright owners and performers.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: October 6, 2014

Darius Van Arman

Exhibit Sponsored By Darius Van Arman

Exhibit No.	Sponsored By	Description
SX EX. 007-DR	Darius Van Arman	Exhibit 1 - Offer Term Sheet

SX EX. 007-DR

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